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The State of the Union

In the traditional annual message to Congress, President Nixon initially offered only a brief and vague description of the State of the Union. He said that the Nation has been going through a long nightmare of war and division, of crime and inflation, and a "long dark night of the American spirit" that now is ending. Later, in attempting to justify his proposals to Congress, he revealed more specifically some important aspects of the state of the Union.

The President proposed to Congress what he described as six great goals: to effect welfare reform, to improve health care, to achieve "full prosperity" in peacetime, to strengthen and renew our state and local governments, to restore and enhance our natural environment, and to reorganize the executive branch of the Federal Government. In this article we shall describe the more important economic implications of the first four of these proposals. If enough additional details about the last two proposals become available to warrant appraisals of their economic significance, we shall provide them in subsequent issues of these reports.

To Effect Welfare Reform

Mr. Nixon cryptically but accurately described one aspect of the state of the Union: the welfare system. He said that this system "has become a monstrous, consuming outrage—an outrage against the taxpayer, and particularly against the children it is supposed to help." He proposed to abolish the existing system and to adopt a new one, presumably similar to that outlined in a message to Congress in August 1969 and rejected by the Senate Finance Committee late last year.

We described the Administration's welfare reform proposal and its economic implications when it was first made a year and a half ago.* We pointed out then that the proposal reflected disregard of uneconomic laws and institutions such as minumum wage laws and many forms of special privilege that account for much poverty, and disregard of the widely different needs of dependent children of poor families in different areas of the Nation. We noted that adoption of the proposal would more than double, to 22.4 million, the number of persons receiving welfare payments and thereby create a large special interest group whose votes politicians would attempt to buy with offers of ever increasing benefits. We also noted that those who proposed this nationwide welfare program ignored the fact that knowledge could be gained at far smaller cost in experimentation with different welfare programs by various states and municipalities.

A much publicized feature of the Administration's original welfare reform proposal was that it allegedly would provide incentive for able recipients of welfare payments to work. The Senate Finance Committee found that the proposal would provide little or no such incentive.

In short, the welfare reform proposal represents an attempt to replace the existing "monstrous, consuming outrage" with another political panacea on a national scale. Because the proposal will not correct the basic conditions that account for much poverty, it would not solve the problem.

To Improve Health Care

The President said that he "will offer a far-reaching set of proposals for improving America's health care and making it available more fairly to more people." Among such proposals will be "a program to insure that no American family will be prevented from obtaining basic medical care by inability to pay"; increased aid to medical schools; incentives to improve the use and allocation of medical care resources; new programs to encourage better preventative medicine; and additional funds to find a cure for cancer.

The general outline of these proposals provided by the President warrants only general comment about their economic implications. However, the President's intention to make medical care "available more fairly to more people" implies the belief that the distribution of such services by a free market is unfair, and that their redistribution by the Federal Government therefore is justified. Government provision of basic medical care regardless of ability to pay for it would be yet another welfare scheme that would involve further compulsory redistribution of wealth.

To Achieve "Full Prosperity" in Peacetime

Mr. Nixon asserted that the rise in the cost of living was reduced last year and that it will be reduced further this year. What are the facts? The average Consumer Price Index for 1969 was 5.4 percent greater than that for 1968, but the average for 1970 was nearly 6 percent greater than that for 1969. The index did increase less rapidly during the second half of 1970 than during the first half (but increased more rapidly during the fourth quarter than during the third). Moreover, the Consumer Price Index does not accurately reflect changes in the cost of living, which we have reason to believe has increased more rapidly than the index has indicated. That the continued rapid rise in the cost of living will be reduced much this year seems doubtful, particularly if expansionary monetary policies result in further inflating.

The President said that as we have moved from "runaway inflation toward reasonable price stability" and from a wartime economy to a peacetime economy, we have paid the price in increased unemployment. To reduce unemployment, he said "I will submit an expansionary budget this year—one that will help stimulate the economy and thereby open up new job

*See *Research Reports* for August 18, 1969. A copy will be sent on request.

opportunities for millions of Americans." Mr. Nixon elaborated by saying: "It will be a full employment budget, a budget designed to be in balance if the economy were operating at its peak potential. By spending as if we were at full employment, we will help to bring about full employment." For the benefit of those who may be misled by the phrase, "a budget designed to be in balance," what the President intends is deliberate deficit spending. He now endorses spending by the Federal Government in excess of expected revenues, that is, a deliberately *unbalanced* budget.

To illustrate how much Mr. Nixon's views have changed during the past year, we quote the following excerpts from his state of the Union message of 1970.

"When I speak of actions which would be beneficial to the American people I can think of none more important than for the Congress to join this Administration in the battle to stop the rise in the cost of living.

"Now I realize it is tempting to blame someone else for inflation. Some blame business for raising prices and some blame unions for asking for more wages. But a review of the stark fiscal facts of the 1960's clearly demonstrates where the primary blame for rising prices must be placed.

"In the decade of the sixties the Federal Government spent $57 billion more than it took in in taxes. In that same decade the American people paid the bill for that deficit in price increases which raised the cost of living for the average family of four by $200 per month in America.

"Now millions of Americans are forced to go into debt today because the Federal Government decided to go into debt yesterday. We must balance our Federal budget so that American families will have a better chance to balance their family budgets."

What accounts for this drastic change in Mr. Nixon's views? Apparently, the fear that continued contraction of business activity and relatively large unemployment would prevent his re-election has led him to embrace the unsound practice that he so emphatically denounced only a year ago.

The President's endorsement of the Keynesian spend-for-prosperity notions has ominous implications for the future economic activity of the Nation. Further deficit spending would increase the Nation's burden of debt and divert resources from job-creating capital formation to consumption. Moreover, evidence provided by the Federal Reserve Bank of St. Louis and our organization indicates that deficit spending that is financed by borrowing existing purchasing media saved by the public provides little or no stimulation to economic activity. If some part of the deficit spending proposed by the President is financed by purchasing media newly created by the banking system, further inflating will result in another artifically stimulated boom and worsening economic maladjustments, including acceleration of the rapid rise in prices condemned so firmly by the President only a year ago.

To Strengthen and Renew Our State and Local Governments

The President's proposal for accomplishing this goal is the sharing of Federal Government revenues with State and local governments on a larger scale than he had originally proposed in August 1969. He recently proposed to provide such governments during the next fiscal year with $5 billion of new and unrestricted funds and with an additional $1 billion of new funds, together with $10 billion now provided for "narrow purpose aid programs," to be used for six broad purposes: urban development, rural development, education, transportation, job training, and law enforcement. The amount of new funds that he would provide is 12 times the amount originally proposed for sharing during the second half of fiscal year 1971.

Except for amounts, the new proposal for revenue sharing is similar to the original proposal, which we described when it was first made.* The adverse economic implications of the new proposal also are similar to those of the old. The principal defect is that State and local government authorities would obtain funds for spending (not only from their own residents but also from those in other States and localities) without having to extract them from taxpayers or to justify their expenditure. Such authorities therefore would become less responsive to their constituents and more subservient to authorities of the Federal Government.

The President described his revenue sharing proposal as a step that would reverse the flow of power from the States and communities to Washington and start power flowing back to the people. Raising revenue by the coercive power of the Federal Government for spending by lesser governments without accountability to taxpayers hardly would involve a reduction of power of the Federal or other governments.

Providing a larger share of revenues to those State and local governments that tax their residents proportionately more probably would foster competitive increases in taxes (as well as spending) in order to obtain a larger share of future Federal "handouts." Revenue sharing would involve confiscating increasing amounts of wealth by the uneconomic, steeply progressive Federal individual and corporate income taxes, which discourage enterprise. Adoption of the proposal would facilitate consumption of wealth via spending for political panaceas and restrict its use for capital formation.

The President said "let us put the money where the needs are." This remark implies that the central planners of the Federal Government know best where the wealth of the Nation's citizens should be distributed. It also implies that such planners endorse the Marxian socialist principle, "From each according to his abilities, to each according to his needs."

The President said that we should share Federal revenues in order to "rescue states and localities from the brink of financial crisis" and "to give homeowners and wage earners a chance to escape from ever-higher property taxes and sales taxes." We note that financial crisis is evident primarily in those States and localities where spending for social welfare purposes has been greatest, such as in New York State and City. Even if revenue sharing would prevent further increases in property and sales taxes (which seems highly improbable), the additional revenue needed for sharing would involve higher Federal taxes. Thus, the implication that revenue sharing would reduce the total burden of taxes is misleading.

To summarize, several of the proposals made by the President in his state of the Union message are unsound, and their adoption would be detrimental to the economic well-being of the United States. The President had much to say about the desirability of reducing the influence of governmental power on the lives of citizens; but nowhere in his message can we find evidence of a desire to reduce the total of wealth confiscated by all levels of government and to permit people to retain more of their wealth to use as they may choose. Although he acknowledged the

*See *Research Reports* for August 25, 1969. A copy will be sent on request.

ineffectiveness of government planners, much of what he proposed would involve confiscating increasing amounts of wealth for redistribution as such planners see fit.

We are particularly concerned that the President has embraced the spend-for- prosperity notions as the basis for fiscal policy. If these notions continue to be applied, as they have been during recent decades, the results will include worsening of already great economic maladjustments, eventual economic collapse, and the demise of the republican form of government in the United States.

STATISTICAL INDICATORS OF CYCLICAL TRENDS

Among the primary leading indicators, manufacturers' new orders for durable goods increased, and housing permits increased markedly, during December. These data did not warrant revisions in previous appraisals of the cyclical status of either of these series, and the percentage of leading indicators expanding cyclically remained at 25.

No additional data on the primary coincident and lagging series were received.

Continuation of the recent improvement among some of the primary leading indicators might be significant for the future trend of general business activity. At present, however, apparent cyclical expansion of only one-quarter of these indicators does not support the expection that such activity soon will begin to expand cyclically.

SUPPLY

INDUSTRIAL PRODUCTION

Production of steel, automobiles, electric power, and lumber (1) in the 1- and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

	1929	*1932*	*1957*	*1961*	*1970*	*1971*
Steel						
Ingots - million tons						
1 week: January 23	1.16	0.43	2.50	1.50	2.52	2.60
4 weeks: January 23	4.32	1.54	9.98	5.44	10.21	9.91
Automobiles						
Vehicles - thousands						
1 week: January 23	88	24	146	95	152	189p
4 weeks: January 23	308	90	536	357	477	602p
Electric Power						
Kilowatt-hours - billions						
1 week: January 23	1.7	1.6	12.4	14.8	30.6	31.6
4 weeks: January 23	6.7	6.3	49.0	57.7	118.9	122.7
Lumber						
Board feet - billions						
1 week: January 16	0.71	0.21	0.62	0.55	0.70	0.63
4 weeks: January 16	2.57	0.94	2.28	1.96	2.30	2.01

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NEW CONSUMER GOODS PER CAPITA

Our seasonally adjusted index of new consumer goods per capita increased 0.1 percent during November but was nearly 3 percent less than that during November 1969. Before adjustment for population growth, which currently is at the rate of about 1.0 percent annually, seasonally adjusted new consumer goods production increased 0.2 percent during November but was almost 2 percent less than that a year earlier.

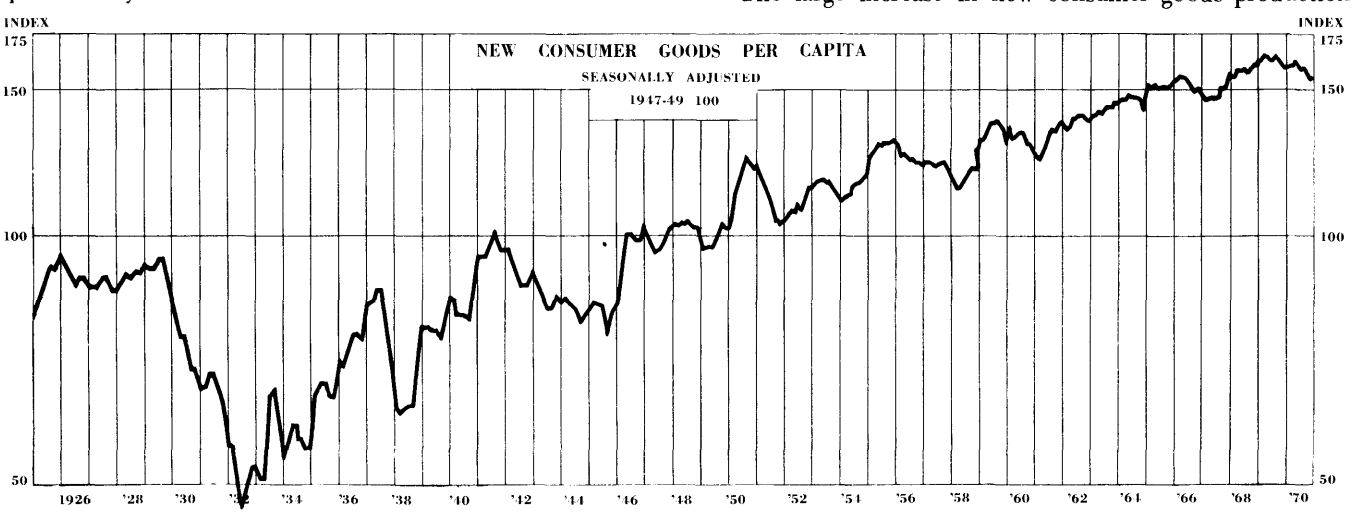
Seasonally adjusted production of manufactured consumer goods increased 2.4 percent during December. Manufactured consumer goods production, including durable and nondurable manufactured goods, accounts for more than three-quarters of total new consumer goods production. Among the principal categories of manufactured consumer goods, production of automotive products during December was nearly 34 percent more than that during November but was 8 percent less than that during December 1969. Home goods and apparel production decreased 0.6 percent during December but was 0.7 percent more than that a year earlier. Production of consumer staples increased 0.3 percent during December and was 0.8 percent more than that during December 1969.

Production of manufactured consumer durable goods, including automotive and home goods, increased 8.8 percent during December and was 0.4 percent more than that a year earlier. Production of manufactured consumer nondurable goods, including apparel and staples, increased 0.4 percent during December but was 0.3 percent less than that a year earlier.

Data on residential construction put in place, which account for almost one-quarter of total new consumer goods produced per capita, are available only through November. Such construction in terms of constant 1957-59 dollars increased 2.3 percent during November and was 0.5 percent greater than that during November 1969.

The seasonally adjusted number of houses started increased nearly 18 percent during December, and the adjusted number started during the last half of 1970 was 29 percent more than that during the first half. The number of privately owned housing units authorized by permits granted increased nearly 17 percent during December. These substantial increases in the number of houses started and permits issued suggest that residential construction put in place will increase further early this year.

The large increase in new consumer goods production



during December was attributable primarily to the marked increase in automobile production as General Motors resumed output following settlement of the strike. Seasonally adjusted automobile production increased 69 percent during December.

The large increase in automobile production during December presumably will be reflected in a large increase in our index of new consumer goods per capita for that month. A further increase in such goods is expected to result from further increases in automobile production and residential construction early this year.

DEMAND

THE HARWOOD INDEX OF INFLATING

The seasonally adjusted index of inflating decreased markedly, by 6 percent, during December to a level about 9 percent less than that a year earlier.

Investment-type assets of the commercial banking system totaled about $464 billion late in December, which was nearly $15 billion more than the revised amount late in November. This increase was relatively about as large as that during December of the preceding 2 years.

Savings-type liabilities increased $6.5 billion during December to $320 billion. The net result of these changes was an increase of $8.6 billion in inflationary purchasing media in use to $147 billion late in December. This amount was nearly 4 percent less than that a year earlier. The effect of this increase was partly offset by an increase of $2.1 billion in noninflationary purchasing media during December. (The index is the ratio of total purchasing media in use to the portion that is *non*inflationary.)

The unusually large increase in savings-type liabilities during December was primarily attributable to an increase of nearly $5 billion in time deposits in commercial banks. This large volume of savings restricted the creation of inflationary purchasing media by these banks to an amount that was much smaller than has been usual during December.

After decreasing greatly during the 6 months ended last August, the seasonally adjusted index of inflating increased markedly during September, changed little during the following 2 months, but decreased markedly during December to little more than the trough reached in August. The expansive policy followed by the monetary authorities during most of 1970 thus did not prevent deflating late last year.

A large increase in the seasonally adjusted amount of Federal Reserve credit during the first 3 weeks of January suggests that an even more expansive monetary policy was followed then. Federal Reserve banks acquired $2 billion more of Government securities during that period, in contrast with the usual practice of selling such securities then in order to absorb commercial bank reserves.

In spite of the expansionary monetary policy followed by Federal Reserve authorities during the final quarter of last year, the amount of inflationary purchasing media created was substantially less than has been usual during that season of the year.

RETAIL SALES

Estimates of retail sales for the most recent week and 4 weeks compare with such sales during the corresponding periods a year earlier as follows:

Period	*Percent Change*
Week ended January 23	+ 8
Four weeks ended January 23	+ 6

PRICES

COMMODITY PRICES

	1970	*1971*	
Index	*Jan. 18*	*Jan. 11*	*Jan. 18*
Spot-market, 22 commodities*	304	278	278
Commodity-futures	289	304	303
Steel-scrap	$40.50	$40.17	$41.17

*For the preceding Tuesday.

Note: The indexes are, respectively, those of the U.S. Bureau of Labor Statistics, Dow-Jones, and *Iron Age*. The spot-market and futures indexes are converted so that their August 1939 daily averages equal 100. The steel-scrap index is a composite price of No. 1 heavy melting scrap.