Published Weekly by
AMERICAN INSTITUTE
for ECONOMIC RESEARCH
Great Barrington, Massachusetts 01230

RESEARCH
REPORTS

Vol. XLIV No. 34 August 22, 1977

Cake For A Few, Costs For You

That most Americans believe that general price levels are increasing much too rapidly seems evident, and one would have to search diligently to find many persons who are unaware of this problem with prices. More and more one hears the plea that "someone should do something about these prices." Often the suggested "someone" has been the Government, and recent U.S. presidents have offered programs to meet this appeal for action against "inflation." President Nixon gave the Nation nearly 3 years of wage and price controls; President Ford had WIN buttons made to publicize his WIN (Whip Inflation Now) program; and President Carter presented his anti-inflation program (which we described in *Research Reports* for May 2 and 9, 1977) shortly after taking office.

These programs ostensibly to reduce the rate of price increases give the "average" American the impression that Government officials are in fact "doing something." Unfortunately these programs actually have been ineffective or counterproductive. Furthermore, even while professing to be fighting inflation, Government officials are fostering even higher prices by their actions. We often have described the relationship between the monetization of Federal deficits, inflating, and increasing prices. We shall not focus on this complex relationship herein. Here we shall focus on Government policies and practices that directly and clearly raise the prices U.S. consumers have to pay.

Government Monopoly

Before we examine specific instances, one fact and its implications should be understood. That fact is that the United States Government is the unit with absolute monopolistic power. One can read of attempts from time to time by the U.S. Justice Department to break up so-called business monopolies in this country, but no single private business company or group of them has the complete monopolistic power of Government. A domestic business corporation constantly faces the actual or possible challenge of new entries in its field, of operating entities or new entries in a substitute field, and of foreign competitors offering its or its substitutes' products.

On the other hand, there is no entity to challenge the Federal Government. It makes the laws and indirectly the myriad regulations that are the rules of the game by which it and all others must operate in this Nation. When it enters the economic arena, the market mechanism becomes distorted or nonfunctional. It can and has set prices, created true monopolies, provided subsidies to favored producers, specified what can be offered to consumers, excluded certain types of foreign products, and taken many other actions whose effects have been to raise prices. Because these are in the form of Federal laws or regulations, there is no threat of having the prices undercut by competition.

As we mentioned above, President Carter, as his predecessors, has asserted that "inflation" is a major problem that must be overcome. With this we thoroughly agree. However, in spite of the rhetoric of his anti-inflation plan presented in April, a number of actions of his Administration will ensure that prices will be higher than they would have been had the actions not been taken. We describe some of these actions and policies below.

U.S. Postal Service

The U.S. Postal Service has the unique distinction of being the only nationwide company in the United States that sells a service for which there are no competitors. Moreover, there can be no competitors for this service, because Federal laws prohibit them. The monopolistic privilege is that of delivering first class mail. Although the Postal Service must compete with private companies for delivering other than first class mail, no company other than the Postal Service is permitted to deliver first class mail.

In May 1977 the Postal Service announced that rates for first class mail should be increased from 13 cents per ounce to 16 cents per ounce in order to reduce the large deficits that this agency has regularly incurred. Would this rate increase be supported by the market if there were competitors of the Postal System? In 1975 Judge Seymour Wenner, administrative law judge of the Postal Rate Commission, recommended that the then 10-cents per ounce first class rate be reduced to 8.5 cents. This was at a time when the Postal Service was seeking to increase the rate to the current 13 cents per ounce. According to Judge Wenner, users of first class mail were subsidizing users of other types of mail by paying rates higher than those that costs would suggest are appropriate. At the same time, rates on other classes of mail were lower than justified by costs. These findings suggest that the Postal Service could not compete with private companies in delivering other than first class mail without a subsidy of these operations or that users of other classes of mail have the political "clout" to force first class users to support them. In either instance, the monopoly power of Government ensures that first class mail users will pay more than they otherwise would pay.

Although this study was done 2 years ago, there is no reason to believe that this situation does not still prevail. First class mail users probably still are subsidizing users of other classes of mail. If this is so, the price of first class mail soon will be increased again to a level probably higher than what the market rate would be if the market were free to function in this economic area.

Trade Restrictions

Any time that trade with other nations is restricted, whether through import quotas, tariffs, or "voluntary" agreements, the result is higher prices for the consumer.

To make this clear, we examine the "justification" for trade restrictions.

Trade restrictions usually are imposed when representatives of a particular industry ask for them because of alleged injury to U.S. employers and employees from the importation of cheaper foreign goods. If the foreign goods were more expensive than the domestic goods, American consumers would not buy them, and there would be no calls for restrictions. The stated benefit of trade restrictions is the protection of American jobs. The method of achieving this benefit is restriction of the volume of foreign goods available for purchase by American consumers. The unstated cost of "protecting" American jobs is higher prices paid by American consumers.

Recently, the Government has extended, imposed, or proposed trade restrictions on four products: textiles, footwear, color televisions, and sugar. However, President Carter acted to ease restrictions on the importation of specialty steel. By supporting more competition in this product, prices of specialty steel undoubtedly are lower than they would be if more severe restrictions had been imposed. This "crumb" for consumers hardly offsets the detrimental effects of increased restrictions on the other products mentioned above.

In July representatives of the United States and other countries that account for about 85 percent of the world trade in textiles approved a 4-year extension of the current international textile agreement. According to Robert Strauss, the U.S. trade negotiator, there is hope that this arrangement "can continue to bring stability and reasonableness to world trade in textiles." This "stability and reasonableness" translates into higher prices for American consumers, inasmuch as imported textile products are much cheaper than such domestic products. In limiting such imports, Government monopoly power will guarantee that domestic producers have a "stable" market, but domestic consumers will pay the price. Is this a part of President Carter's anti-inflation program?

In May U.S. trade negotiators reached separate agreements with Japan for restricting imports of color televisions and with Korea and Taiwan for restricting imports of footwear. The agreement with Japan limits the number of less expensive Japanese televisions that can be imported for 3 years beginning July 1, 1977. American buyers of television sets will have fewer buying options as a result of this agreement. Either they will buy more expensive American sets or go without.

The restrictions on footwear will limit imports of those products from Korea and Taiwan for the 4 years beginning June 28, 1977. A probable result of this action will be a shortage of low priced "joggers" and plastic sandals, which are major items imported from those nations. According to a study done by Brimmer & Company, a consultant for the Volume Footwear Retailers of America, domestic producers probably will try to enter the market for such products, but their prices will be higher. That study estimated that the restrictions will cost American consumers an extra $1 *billion* during the first year alone, while reducing consumers' choices at the same time.

The farm bill that reportedly will be approved by a joint Senate-House conference in early September contains a provision that allows the Government to support the price of sugar at *no less than* 13.5 cents per pound, or about 2 cents per pound more than the current price. According to *The Wall Street Journal*, Government officials indicated that they probably will impose a tariff on imported sugar in order to force the domestic price higher. In this instance the officials did not even attempt to hide the fact that their actions will force higher prices.

Only 2 years ago, when sugar prices were soaring, Government officials excoriated U.S. sugar companies for their pricing practices, and hearings were held to look into these "monopolistic" practices of domestic sugar manufacturers. Before the Government could act at that time, the market system fostered appropriate adjustments, and sugar prices fell. One can be sure that no such favorable adjustments will take place to the current price hikes for sugar; Government monopoly power precludes effective market adjustments.

Another recent Government policy does not restrict international trade but requires that a certain percentage of imported goods be shipped on domestic carriers. Specifically, it requires that 4.5 percent of oil imported into the United States be carried in U.S.-flag vessels. This percentage would increase to 9.5 percent within 5 years. Because of the monopolistic power of organized U.S. maritime workers, the cost of operating U.S. tankers is more than double that of operating foreign tankers. With this bill, Congress and the Administration are shielding this monopolistic power from foreign competition. This bill has been widely reported to be a payment to the Marine Engineers Beneficial Association and its 6,000 members by the Democratic Party and President Carter for the union's support in last November's election. The net result of this bill would be higher U.S. oil prices. According to *The Wall Street Journal*, the cost to consumers during those 5 years would be about $7 *billion*. That is quite a payment the Administration is extracting from the American public for a political payoff. It is more than $1 million per union member, and this payoff is completely safe from any competitive market force.

Mandated Changes

The monopolistic power of the Federal Government to force higher prices on American consumers is nearly unlimited in breadth. On June 30, 1977, Secretary of Transportation Brock Adams announced that all automobiles produced in 1984 and thereafter will have to be equipped with either an automatic seat belt system or an air bag system. Americans already have shown their dislike for a seat belt system. When that system was mandatory in 1974 many people found ways to bypass it, and eventually that law was overturned. The more expensive air bags will add between $100 and $300 to the cost of a new automobile. Moreover, if the bag must be reinstalled after use, the cost reportedly will be about double the original installation charge. Substantial controversy has surrounded the air bag system. Proponents of it have said that it would reduce automobile insurance premiums, and this "saving" would offset some of the cost of the system. Proponents also have asserted that reinstallation insurance probably will be available for as little as $1 annually.

Nobody, however, denies that the air bag system will increase the cost of automobile transportation, and that is our focus here. If Government officials are going to force prices up by such means, they later should not blame the results on others. For the sake of accuracy and the possibility of sound future decisions, the public should understand that such higher costs were forced upon them by their officials who believed the "benefits" provided were worth the higher costs.

The cost-benefit relationship of other Government

regulations also should be considered. Forcing utilities to convert from using oil or natural gas to using coal certainly will cost the consumer higher utility rates. However, any benefit from this switch depends upon many factors, the most important being the relative supplies of these fuels. Since no one knows the absolute supplies or the price needed to recover them, the benefit of conversion from one fuel to another can not be known. Nevertheless, consumers surely will experience the costs.

Final Comment

The Government actions described herein that have the effect of raising prices of specific classes of products need not raise the general price level. However, Keynesian economic theories offer politicians the delusion that the harsh adjustments to rising relative costs (falling prices for some other things and/or increasing unemployment) can be avoided. In an effort to hide from the voting public these real costs of their price-hiking programs, politicians have adopted other policies (spending programs and budget deficits) that have fostered inflating and increases in the general level of prices.

Voters should realize by now that there is no way to have one's cake and eat it too. If Government officials decide to use the monopolistic power of the Government to give special rewards to some groups, nonmembers of those groups are going to pay for those rewards one way or another.

BUSINESS

CONSTRUCTION

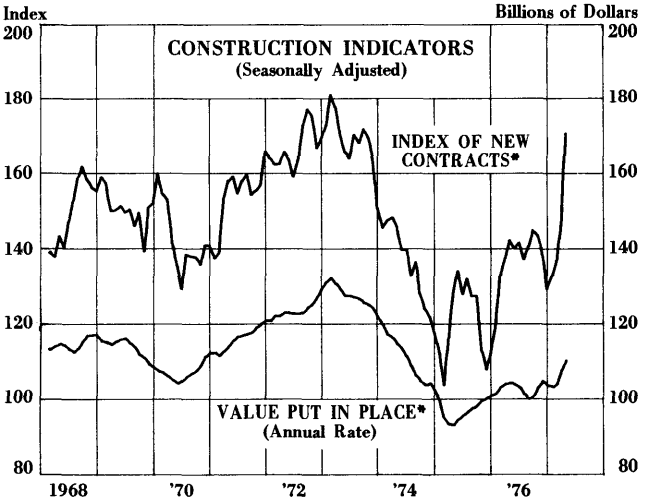
Note: All data are seasonally adjusted.

According to the Department of Commerce, the value of construction put in place during the 3 months ended with May was $41.6 billion. This amount was 8.3 percent more than that during the preceding 3 months and 12.7 percent more than that during the 3 months ended in May 1976.

The composite index of construction costs prepared by the Department of Commerce was 152.0 (1972=100) during May. This level was 1 percent more than that 3 months earlier and 6.5 percent more than that a year earlier.

The physical volume of construction activity can be estimated by dividing the current-dollar value of construction put in place by the index of construction costs. This estimate is the value of construction put in place in constant dollars. During the 3 months ended in May, the physical volume of construction activity so estimated was 6.6 percent more than that during the preceding 3 months and 6.1 percent more than that a year earlier. The 3-month moving average of this series is shown in the accompanying chart. Although the trend of this series clearly is upward, the underlying rate of expansion probably is not as large as suggested by the increases during very recent months. These increases may reflect in part problems of seasonal adjustment. The reported fluctuations in this series during 1976 and 1977 may be less pronounced when the final seasonal factors are estimated and applied to the unadjusted data. After such future revisions, the series since mid-1976 might be as smooth as it was during earlier periods. The trend over longer periods probably is more significant than the large increases during the past few months.

Although the trend of the constant-dollar value put in place series has been upward since the first half of 1975, the recovery of construction activity from its



*3-month moving averages of 1972-dollar series.

cyclical trough then generally has been gradual. The recent volume of such activity remains smaller than that during most of the preceding decade, and the record volume of construction activity during early 1973 was 20 percent larger than the recent volume.

The 3-month moving average of the index of new construction contracts (deflated by the index of construction costs) also is shown in the chart. In spite of erratic fluctuations, cyclical trends in this series seem to change in advance of changes in the trends of the value of construction put in place, and the index of new construction contracts may provide some indication of the near-future trend of construction activity. The new contracts series decreased late in 1976, but it has increased markedly since then, which is favorable for the near-future trend of construction activity.

The accompanying table shows the current-dollar value of construction put in place during the 3 months ended in May (at annual rates) for various categories of construction. Also shown for each category is the change in the physical volume (constant-dollar series) from the preceding and year-earlier 3-month periods. As the data show, single-family houses comprise the largest portion of construction activity. The recent volume of such activity was a record and was about 13 percent larger than the previous record volume during early 1973. The con-

VALUE OF NEW CONSTRUCTION PUT IN PLACE
(During 3 months ended with May)

	*Amount**	*Percent Change† From*	
		Preceding 3 Month Period	*Year-Earlier 3 Month Period*
Private			
One-family houses	$53.1	+13.3	+25.9
Multi-family houses	10.9	+21.0	+48.3
New Housing	*$64.0*	*+14.5*	*+29.2*
Other residential	14.3	−6.4	−6.6
Residential	*$78.3*	*+10.0*	*+20.8*
Nonresidential bldgs.	27.0	+5.4	−1.3
Other private	24.6	−2.5	+3.1
Total Private	*$129.9*	*+6.5*	*+11.8*
Public			
Public buildings	$12.2	+4.8	−17.0
Highways and streets	9.2	+16.2	−15.2
Other public	15.1	+3.2	−3.5
Total Public	*$36.5*	*+6.9*	*−11.6*
Total Construction	$166.4	+6.6	+6.1

* In billions of current dollars, seasonally adjusted annual rates.
† Percent changes based on constant-dollar values.

struction of new single-family houses recently accounted for about 32 percent of all construction activity; in early 1973 that proportion was 23 percent.

All types of contruction activity decreased markedly during the 1973-75 recession, but apartment (multi-family) construction decreased until about mid-1976. The large percentage increases in apartment construction during recent months are not so much attributable to large absolute increases as to small increases from a much reduced base. The recent level of apartment construction was 65 percent less than that of the 1973 record.

The trend of public construction activity has been gradually downward since 1968. The increase in this activity during the 3 months ended in May does not necessarily indicate that this downward trend has ended, for short-term reversals of several months have occurred from time to time since 1968. The recent increases probably are attributable to Government spending programs that could prolong the improvement for some additional months. Private nonresidential construction activity, which includes outlays by manufacturing, transportation, and utility firms, has changed little since 1975.

In contrast to the early 1970's, when construction costs rose much more rapidly than consumer prices in general, construction costs since 1973 have increased at about the same rate as consumer prices. This, and the fact that single-family house construction has returned to record levels while other forms of construction have remained relatively depressed, suggest that the total of construction activity during 1972 and 1973 reflected a distorted situation. That situation probably was aggravated by, if not fostered by, various Government construction subsidies and programs, one of which was the Tax Reform Act of 1969 giving favorable treatment to real estate investment trusts. The volume of construction activity during 1973 probably will not be exceeded for some time. This should be viewed as favorable for the continuation of the current upward trend of such activity.

The recovery of construction activity from the 1975 trough probably will remain gradual, at least until constant-dollar outlays for private nonresidential construction begin to increase substantially.

STATISTICAL INDICATORS

Among the primary leading indicators of business-cycle changes, the index of net business formation increased slightly during May, but the 2-month moving average of this series has decreased for 2 months. As a result of these decreases we now appraise the series as probably expanding rather than clearly expanding. Both the inverted layoff rate in manufacturing employment and new orders for consumer goods and materials in constant dollars decreased during June. Recent decreases in the moving averages of these series also have raised some doubt that they still are expanding cyclically. Contracts and orders for plant and equipment in constant dollars and the index of housing permits decreased slightly during June and July, respectively. However, the moving averages of these series continued to increase, and we continue to appraise these series as expanding. Vendor performance increased slightly during June. Nevertheless, no cyclical trend in this series yet is apparent, and its cyclical status remains indeterminate. The percentage of primary leading series appraised as expanding cyclically remains 89.

The index of industrial production increased and continued to expand cyclically during July. The nonagricultural employment ratio decreased during July; however, the moving average of this series continued to increase during the most recent month. This series remains appraised as expanding cyclically. All of the primary roughly coincident indicators are appraised as expanding cyclically.

Both the series commercial and industrial loans outstanding and the ratio of labor cost to unit of output increased during June. They and all of the other primary lagging series are appraised as expanding cyclically.

In spite of recent decreases in some of the primary leading series, eight such series remain appraised as expanding cyclically and only one is appraised as contracting. The expansion of 89 percent of the leading series for which trends are evident warrants the conclusion that general business activity probably will continue to expand for the next few months, at least.

SUPPLY

INDUSTRIAL PRODUCTION

Production of steel, automobiles, and electric power (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:

Steel	*1972*	*1973*	*1974*	*1975*	*1976*	*1977*
Ingots (million tons)						
1 week: August 13	2.42	2.77	2.73	1.92	2.53	2.33
4 weeks: August 13	9.54	11.19	11.00	7.71	10.29	9.21
Automobiles						
Vehicles (thousands)						
1 week: August 13	76	57	69	104	102	98p
4 weeks: August 13	297	505	408	391	396	500p
Electric Power						
Kilowatt-hours (billions)						
1 week: August 13	35.4	40.3	37.9	40.9	72.0	45.6
4 weeks: August 13	147.2	158.4	159.6	163.3	169.0	181.7

Percent change from 4 weeks a year earlier: +7.5

p Preliminary.

DEMAND

RETAIL SALES

Estimates of retail sales during 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 August 13	+12
Four weeks ended August 13	+11

PRICES

COMMODITIES PRICES

	1976	*1977*	
Index	*Aug. 9*	*Aug. 1*	*Aug. 8*
Spot-market, 22 commodities*	541	531	523
Commodity-futures	685	722	696
Steel-scrap	$81.83	$61.50	$61.50
	Aug. 19	*Aug. 11*	*Aug. 18*
Gold	$109.45	$145.35	$143.55

*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 for No. 1 heavy melting scrap. The gold price is the final fixing in London.

Research Reports is published weekly at Great Barrington, Massachusetts 01230 by American Institute for Economic Research, a nonprofit, scientific, educational, and charitable organization. Second class postage paid at Great Barrington, Massachusetts 01230. Sustaining membership: $9 per quarter or $35 per year.