

SCOMM

#9:15

Israel's Other War



After my first visit to Israel fifteen years ago, I summarized my impressions by saying that two Jewish traditions were at war in Israel: a 100-year-old tradition of belief in paternalistic socialist government and of rejection of capitalism and free markets; and a 2,000-year-old tradition, developed out of the necessities of the Diaspora, of self-reliance and voluntary cooperation, of getting around government controls, of using every device of Jewish ingenuity to take advantage of such opportunities as escaped the clumsy grasp of government officials. I concluded that, fortunately for Israel, the older tradition was proving the stronger.

On a recent visit to Israel, shortly after the elections that, to everyone's astonishment, voted in the Likud bloc, I found that the war between these two traditions had moved into a new phase. Though the socialist doctrine had been winning the war in practice, it had been losing the war in public opinion.

SPREAD OF SOCIALIST PRACTICE

Government controls over the Israeli economy have mushroomed apace. Roughly one-third of the Israeli working force is employed by the government directly, and another third by the Histadrut—a quasi-governmental industrial-labor complex. Total government spending (adjusted for funds from abroad) amounts to some 60 to 70 per cent of national income. Subsidies are a way of life: to labor and industry; to farmers and consumers of food; to homeowners and renters. And so are taxes and inflation.

A large government sector is not a recent phenomenon. But it has changed its character, as the selfless idealists who were initially in control were replaced, or themselves turned into the very different types who were tempted by opportunities for privilege and profit to seek and gain positions of power. In addition, the mere passage of time produces increasingly rigid and harmful controls and regulations, an accumulation of costly and wasteful projects, a canceling of benefits by burdens, entrenched privilege, and corruption. It is easier to pass laws than to repeal them; to enact regulations than to correct them. Government bureaucrats may do as good a job as profit-seeking entrepreneurs in selecting projects to undertake. But while losses forcibly end strictly private failures, the tax collector is always there to provide artificial respiration to governmental failures.

Until the Yom Kippur war of 1973, Israel nonetheless was able to grow rapidly. The influx of people and capital from abroad, plus the strength of the earlier tradition, were, in Adam Smith's words from his 1776 masterpiece, "powerful enough to maintain the natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration." But then growth came to a screeching halt. In the past three years, output has been roughly constant, while inflation has averaged nearly 40 per cent a year.

The Labor government naturally cited the needs of defense as an excuse for both economic difficulties and the mammoth government budget. True, the defense burden is heavy, particularly in ways that do not show up in the budget—such as the drain of manpower for reserve military duty. However, if military aid from abroad is subtracted from total military cost, the remainder which is financed from domestic sources amounts to only about one-quarter of total government spending (similarly adjusted for funds from abroad).

DECLINE OF SOCIALIST OPINION

The use of socialist rhetoric to justify and protect positions of privilege and power plus socialism's failure to deliver the goods have generated growing public cynicism. In addition, there has been a reaction in Israel, especially among the young, against widening government controls—matching the reaction in most of the Western world, including the U.S.

In Israel, these tendencies have been reinforced by the division between the Ashkenazim, the Jews of European extraction, and the Sephardim, the more recent flood of immigrants from the Arab and Islamic countries. The socialist doctrine was an Ashkenazic import and has been implemented primarily by Ashkenazim. The Sephardim had no similar tradition. As Bernard Avishai put it in a recent article in *The New York Review of Books* (June 23, 1977), "The citizens of the 'second Israel' are fiercely resentful of the Labor movement for having turned the whole country into what they perceive as a European closed shop . . . Labor has been seen as the party of privilege and cultural snobbery, especially among residents of and escapees from the poorer Sephardic neighborhoods."

This change in public opinion, and the associated domestic economic difficulties, had far more to do with the defeat

of the Labor Party and the victory of the Likud alliance than the differences over foreign policy that have been so much discussed in the American press.

There is a wide consensus in Israel, that ranges over all parties except for fringe extremists, on the substance of foreign policy. The much-discussed differences are almost entirely about the rhetoric in which it is thought tactically expedient to clothe that policy.

The modern miracle of Israel was achieved by free men and women fighting against incredible odds. The true hope of Israel—and of freedom everywhere—is the enterprise, initiative, ingenuity, drive, and courage of the individual citizens, cooperating voluntarily with one another, producing the incredible progress in every sphere that comes only from the activities of the individual. The threat from its neighbors unfortunately mandates a large military effort on Israel. That effort must be coordinated and administered by government. Hence, Israel cannot escape having a sizable socialist sector. But that sector can remain as it has been, relatively efficient only so long as it is supported by a free people and a strong, productive, private economy.

PROSPECTS FOR CHANGE

Prime Minister Begin and his government have proclaimed their intention to cut government down to size and to give greater scope to the free market. Much as I approve of these objectives, their attainment will not be easy. Too many groups have a vested interest in government subsidies, including many of the strongest supporters of the Likud. In a discussion that I had in Israel with a group of private businessmen, private farmers and private bankers, the business leaders expressed support for eliminating government subsidies—provided the process started with agriculture. The leaders of agriculture expressed support for eliminating government subsidies—provided the process started with business. Ditto the bankers.

It will be a triumph of leadership and idealism if Prime Minister Begin and his government can untangle the snarl they inherited from the 29-year rule of their socialist opponents. Their success is vital both for Israel and for free men everywhere. I wish them well.

WHERE CARTER IS GOING WRONG

Interview With Nobel Prize Winner Milton Friedman

The President's plan to spur the economy with tax cuts and more federal spending will simply bring on more inflation, warns economist Friedman, who gives his prescription for lower unemployment with stable prices.

Q Professor Friedman, will President Carter's program of tax cuts and spending stimulate the economy?

A There is nothing in the package which will stimulate anything. How can the Government stimulate the economy by taking money out of one pocket of the public and putting it into another pocket? The rebate plan, for example, would distribute \$50 apiece to most consumers. As a result, those consumers will tend to spend more. But where will the Government get the money to send out the rebates?

Q But almost everyone looks on the rebate as a good way to stimulate the economy—

A It appears to be a stimulant because people are looking at the visible effects and paying no attention to the invisible effects. The \$50 rebate checks and the extra expenditures by consumers that will result are very visible. The people who will not have employment because the Government will borrow the money or cause more inflation are not very visible. Nobody notices them.

Q How about the proposals for increasing federal outlays on public works and public-service jobs, which are also part of the Carter program?

A The same thing applies. If the Government spends money on a public-works program or hires people, where does it get the money to spend?

Q So you believe the Carter program will do more harm than good—

A On the whole, I think that's the case. I'm in favor of tax reduction under any and all circumstances as the only effective way to put a lid on total Government spending. But the particular form of tax reduction that is proposed in this program is undesirable. It proposes to give rebates on a basis that has no relation to current activity.

If we're going to reduce taxes, we should at least reduce them in a way that will give people an incentive to save more or work harder, not simply drop checks out of airplanes. We ought to make it a permanent reduction in taxes.

Q There is some permanent reduction included in the Carter plan, apart from the rebates—

A Yes, but even that is somewhat misleading. President Carter really is not proposing to reduce taxes; he is proposing to increase them.

Q How so?

A The real tax burden on the American people is the amount the Government spends, not the amount that is labeled "taxes." If the Federal Government spends 460 billion dollars in fiscal year 1978, which is roughly what the President proposes, and takes in something like 400 billion in taxes, who do you suppose pays the other 60 billion? The tooth fairy? Or the Arab sheiks?

The American people pay it. It's paid in the form of the hidden tax of inflation or, if it's financed by borrowing from the



Professor Friedman, 64, profoundly influenced the thinking of world officials with his studies on the role of money, done largely at the University of Chicago. Now on leave, he is a visiting scholar at San Francisco's Federal Reserve Bank.

public, then in the form of higher taxes that will be needed in the future to pay the interest and the principal. That means that it lowers the value of all property today to the extent that property will be subject to higher future tax burdens.

Q How much inflation do you think the Carter economic package will cause?

A That depends on how the Federal Reserve behaves. It has been expanding the money supply too rapidly, and that implies that inflation was going to speed up anyhow, regardless of this program.

I should also point out that Carter's program is very small in magnitude. It is obviously an attempt to offer the smallest program possible while throwing bones to as many groups of supporters as possible. From that point of view, it makes a lot of sense. The economy is growing at a healthy pace, and it would be unwise politically for the President to speed things up even if he could.

Q In the final analysis, will the Federal Reserve simply create the money to pay for the Carter tax cuts and spending increases and lend it to the U.S. Treasury?

A If the funds are supplied by the Federal Reserve, that will produce more inflation and thus destroy private jobs to the same extent that it creates Government-financed jobs.

Q But isn't it true that the additional borrowing and spending will add to inflation only if the Federal Reserve increases the supply of money faster than the supply of goods and services increases? Federal Reserve Chairman Arthur Burns has indicated he thinks he can avoid doing that—

A The plain fact is that the quantity of money has already been increasing faster than output. Chairman Burns indicated in his recent testimony that the narrow money supply— M_1 —would have to increase at only about zero to 2 per cent per year to avoid inflation, and the broad money supply— M_2 —at about 3 to 5 per cent. Yet his announced targets are far higher than that— $4\frac{1}{2}$ to $6\frac{1}{2}$ per cent for M_1 , 7 to 10 per cent for M_2 —and actual monetary growth has recently been even faster.

Q What if the Treasury sells bonds to the public to cover the Carter deficit?

A If the Treasury borrows from the public, there will be less money left in the hands of private investors to be loaned out and spent for building houses and creating new factories and machines. The result is to reduce private employment and increase publicly financed employment.

Q What would you do about high unemployment?

A The long-range solution is to increase the incentive for ordinary people to save, invest, work and employ others. We make it costly for employers to employ people, and we subsidize people not to go to work. We have a system that increasingly taxes work and subsidizes nonwork.

Q How could that be changed?

A First, I propose that the Federal Reserve reduce the rate of monetary growth gradually over the next three years by about 2 percentage points a year until they get to a rate that is in keeping with the long-run increase in economic output. That would eliminate the inflationary bias in the economy.

I would simultaneously index personal and corporate income taxes—that is, automatically adjust personal exemptions, tax brackets and so on for inflation. That would keep inflation from automatically driving taxes up and be far more effective than the measures Mr. Carter and others have proposed. Congress has been very prompt in protecting its own salaries against inflation. It has done nothing to protect the public.

Finally, I would cut the real taxes borne by the American people by cutting all Government spending 10 per cent across the board.

Q Do you also favor increasing the tax credit for investments in new plant and equipment?

A No. Those credits do not stimulate capital investment; it only looks as if they do.

Suppose a company invests more money to take advantage of the credit. Where does it get the money? From profits or from loans. So the real question is whether the credit increases the total pool of funds available for investment.

If it reduces taxes, it may seem to increase the pool, but then we have to ask: Who pays the taxes instead of the companies that take the credit? All it does is to divert investment into directions which qualify for the credit and away from investments that don't. It has a negligible effect on increasing the total pool.

The most effective way to stimulate capital is to put investment on equal terms with everything else, and that means moving toward a tax that you pay on what you spend instead of on your income. But if we are going to retain the income tax, then we ought to abolish the tax on corporate profits and require the companies to attribute their income to their stockholders, whether they pay it out in dividends or not. The stockholders would bear the tax burden directly and openly instead of, as now, indirectly.

Q Are there steps that could be taken to reform the tax system short of switching over entirely to a tax on spending?

A If we simply replaced all tax rates above 25 per cent with a flat 25 per cent rate, taxpayers would lose interest in tax shelters, and the amount of revenue the Government takes in would almost surely increase at the same time as the taxpayers benefited. But there is not one chance in a million of Congress enacting such a simple measure.

Q What would your plan for tax-and-spending cuts do for employment?

A It would mean a healthy increase. It would reduce Government jobs and increase private jobs. People would have more incentive to work.

You see, the problem today isn't lack of purchasing power, which the rebates are supposed to remedy. We've had too much purchasing power. That's why we've had so much inflation. How can the problem be purchasing power when prices are rising 5 per cent a year now and, in my opinion, will be going up at a rate of 7 to 9 per cent over the next two years?

Q Can that inflation be reduced through Government guidelines—or jawboning, as it's called?

A Such measures have temporary effect, but over any long period they are harmful.

There's only one place where inflation is made: That's in Washington. I don't mean that people in Washington impose inflation on the rest of the community for no good reason. Inflation is made in Washington in response to pressures from the people at large.

The people who are really making inflation are the voting public—because they ask their Congressmen to enact goodies in the form of spending, but they are unhappy about having taxes raised to pay for those goodies. The only way Congress can spend more without appearing to raise taxes is through inflation.

Q The President's economic advisers say that a great deal of our inflation has been caused by special circumstances that raised the cost of oil, other fuels, foods and so on—

A That's wrong, and the proof of it is very simple:

Those special circumstances affected all countries. So why is it that they were followed by inflation at a rate of 2 per cent in Switzerland, 6 per cent in Germany, 12 per cent in the United States, 25 per cent in Britain and 30 per cent in Japan?

It cannot be that the same factors had such widely different results. This is simply a case of trying to find excuses.

Q Some economists say the U.S. is in for a period of relatively slow economic growth. Do you agree?

A We're not doomed to any such period, but we may have one if the heavy hand of Government regulation continues to interfere with the effective use of our resources.

There is nothing of a technical or necessary character that will slow economic growth. On the contrary, if we could cut the Government back to size, reduce some of its regulatory activity—for example, eliminate the price controls on oil and natural gas—we could have a period of very rapid economic growth.

Q Wouldn't we still face shortages of oil and gas?

A There is no physical shortage of fuel and energy—only an artificial shortage created by bad Government policies.

The Organization of Petroleum Exporting Countries has produced a serious artificial shortage of oil, and the United States has greatly exacerbated the economic effects of the OPEC strategy by its own policy. Our Government is providing a subsidy of roughly \$3 a barrel on oil imported from the OPEC countries through its scheme to equalize the cost of refining imported oil and artificially cheaper domestic oil.

Q Isn't it true that the United States



King Carl XVI Gustaf awarding Nobel Prize in economics to Friedman in Stockholm last year.



Jobless-pay lines: Toll is highest among young blacks. "We have a system that increasingly taxes work and subsidizes nonwork."

INTERVIEW WITH MILTON FRIEDMAN

[continued from preceding page]

is running out of large deposits of oil and gas that can be exploited at relatively low cost?

A There is a physical limit to our reserves.

But remember that there was also a big scare in the 1920s, when it was said that reserves of oil would only last 20 years. Since that time, consumption has increased dramatically, and so have reserves.

If we allowed the price system to operate, we would reverse the trend toward reduced domestic production of oil and gas for the immediate future and enable the adjustment to dwindling reserves to be met over a considerable period of time.

Q Turning back to the problem of creating more jobs, what do you think of proposals to give employers tax credits or bonuses if they hire the unemployed?

A The Carter plan for giving a credit equal to 4 per cent of the employer's Social Security payroll tax is ludicrous. It is simply a proposal to reduce the payroll tax from 11.7 per cent of wages to 11.66 per cent.

That's all it is when you take away the Madison Avenue packaging. Who would give it a second thought if it were explained in that straightforward manner?

Q But there are proposals in Congress for more-generous bonuses for hiring, aren't there?

A The bonus schemes will encourage employers to fire some people in order to employ others who will qualify for the subsidy. The Government will then try to close that loophole, and the complexity of the program will grow and grow. It will create employment all right—for more federal bureaucrats to administer the program.

Q Should government do anything to help black teenagers, who have the highest rate of unemployment?

A These young people are disadvantaged in part because of government policies—for example, the kind of schooling they get, which is provided by government.

The effective way to reduce black teen-age unemployment over the long run would be to introduce a voucher system for education. That would introduce competition into the schools, particularly in the slum areas of our big cities, and that would tend to upgrade the kind of schooling the young blacks can get.

As it is, the government first provides very poor schooling, and then the harm is multiplied by the minimum-wage law, which makes it difficult for them to get on-the-job training. Without the minimum-wage law, the least skilled could offer to work for low wages, which would provide an incentive for employers to hire and train them. It has always been a mystery to me why a teen-ager is better off unemployed at \$2.30 an hour rather than employed at, say, \$2.

Q Should the United States do more to help the underdeveloped countries?

A Who says we've been helping them? We have been granting subsidies to underdeveloped countries, and the evidence is overwhelming that this has been hurting them, not helping them. What we have done is to strengthen the small clique which is in charge of the governments in these countries at the expense of the populace at large.

Q What should be done?

A The most effective thing we could do to help would be to drop our tariffs and thus encourage the underdeveloped countries to compete on fair and open terms and sell us whatever they can. That would do far more good than shoveling out bushels of money to maintain governments that do not effectively represent the public at large.

Q Should the U.S. cut tariffs unilaterally?

A We have little control over what Britain or Germany or Japan does. I would like to see the United States act like the great nation it is and unilaterally reduce trade barriers across the board.

Q What if other countries dump goods into our market at less than cost and ruin industries employing our workers?

A People who say free trade does that are not looking at what happens to exchange rates.

Suppose Japan is so foolish as to subsidize every export to the United States, so that there is nothing we can sell them and everything they have to sell is cheaper than what we produce here. How would we pay for their exports? We would send them dollars. What would they do with the dollars? The Japanese who know them would say: "There's nothing we can buy with these dollars. Everything in the U.S. is too expensive at the present exchange rate."

So instead of valuing a dollar at 300 yen, the Japanese would say: "The dollar isn't worth anything to me. I'll give it to you for 200 yen." If that doesn't work, the rate will go to 100. And the result will be that the price of Japanese goods will go up in terms of dollars while U.S. goods will become cheaper in Japan.

That swing will continue until the amount the U.S. is selling to Japan is roughly equal to what Japan is selling to the United States. In the process, we will have less employment in those industries in which we are inefficient compared with the Japanese, and more employment in those in which we are most efficient.

This is difficult for most people to see because we overemphasize the visible effects and neglect the invisible. If Japan exports more steel to us, the people in the steel industry who lose their jobs are very visible. The fact that Japan earns more dollars and buys many other goods, so that we have more people employed in export industries, is not nearly as visible.

Q Do you suggest that tariffs be wiped out overnight?

A I would favor doing it over a five-year period in order to make the adjustment easier.

Q Looking ahead, what do you see as the greatest economic problem facing this country?

A The growth of government. We are going down the same road as Great Britain. We are 10 or 20 years behind Great Britain, but if we keep on the way we are going, we will be in the same state that Britain is in now.

Forty per cent of our national income is being spent by the federal, State and local governments. Fifty years ago the proportion was 10 per cent. Are we getting our money's worth?

I would like to see a constitutional amendment that would say that spending for all purposes by the Federal Government could not exceed 25 per cent of the income of the people. That is roughly what it is now. So the amendment would not reverse the trend, but at least it would stop it and give time for a change in attitudes and a growth in understanding to develop that would make a reversal politically feasible.

U.S. News & WORLD REPORT

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U.S. NEWS & WORLD REPORT

2300 N Street, N.W., Washington, D. C. 20037

By Milton Friedman

Fair Versus Free

In presenting his energy program, President Carter stressed "fairness" as an essential ingredient of an acceptable program. The Federal Communications Commission seeks to enforce a "fairness doctrine" on radio and TV stations. We suffered numerous "fair trade" laws, until they were declared unenforceable. One businessman vies with another in proclaiming his faith in competition—provided that it is "fair."

Yet, scrutinize word for word the Declaration of Independence, the Constitution and the Bill of Rights, and you will not find the word "fair." The First Amendment does not protect the "fair" exercise of religion, but the "free" exercise thereof; it does not restrain Congress from abridging the "fairness" of speech or of the press, but the "freedom" of speech, or of the press.

FROM UMPIRE TO BIG BROTHER

The modern tendency to substitute "fair" for "free" reveals how far we have moved from the initial conception of the Founding Fathers. They viewed government as policeman and umpire. They sought to establish a framework within which individuals could pursue their own objectives in their own way, separately or through voluntary cooperation, provided only that they did not interfere with the freedom of others to do likewise.

The modern conception is very different. Government has become Big Brother. Its function has become to protect the citizen, not merely from his fellows, but from himself, whether he wants to be protected or not. Government is not simply an umpire but an active participant, entering into every nook and cranny of social and economic activity. All this, in order to promote the high-minded goals of "fairness," "justice," "equality."

Does this not constitute progress? A move toward a more humane society? Quite the contrary. When "fairness" replaces "freedom," all our liberties are in danger. In "Walden," Thoreau says: "If I knew for a certainty that a man was coming to my house with the conscious design of doing me good, I should run for my life." That is the way I feel when I hear my "servants" in Washington assuring me of the "fairness" of their edicts.

There is no objective standard of "fairness." "Fairness" is strictly in

the eye of the beholder. If speech must be fair, then it cannot also be free; someone must decide what is fair. A radio station is not free to transmit unfair speech—as judged by the bureaucrats at the Federal Communications Commission. If the printed press were subject to a comparable "fairness doctrine," it too would have to be controlled by a government bureau and our vaunted free press would soon become a historical curiosity.

What is true for speech—where the conflict is perhaps clearest—is equally true for every other area. To a producer or seller, a "fair" price is a high price. To the buyer or consumer, a "fair" price is a low price. How is the conflict to be adjudicated? By competition in a free market? Or by government bureaucrats in a "fair" market?

Businessmen who sing the glories of free enterprise and then demand "fair" competition are enemies, not friends, of free markets. To them, "fair" competition is a euphemism for a price-fixing agreement. They are exemplifying Adam Smith's remark that "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." For consumers, the more "unfair" the competition the better. That assures lowest prices and highest quality.

RULES OR ACTIONS

Is then the search for "fairness" all a mistake? Not at all. There is a real role for fairness, but that role is in constructing general rules and adjudicating disputes about the rules, not in determining the outcome of our separate activities. That is the sense in which we speak of a "fair" game and a "fair" umpire. If we applied the present doctrine of "fairness" to a football game, the referee would be required after each play to move the ball backward or forward enough to make sure that the game ended in a draw!

Our Founding Fathers designed a fair Constitution to protect human freedom. In Thomas Jefferson's ringing phrases from the Declaration of Independence, "Governments are instituted among Men" "to secure" "certain unalienable Rights, that among these are Life, Liberty, and the Pursuit of Happiness."



ministration energy official. His prognosis: the companies will get their guarantees, the coal-gasification plants will be built—and the U.S. will have a new source of energy.

—ALLAN J. MAYER with WILLIAM J. COOK in Washington and bureau reports

Secrets of the Nazis

One of the first spoils of the Nazi defeat in World War II was a treasure trove of documents: more than a million pages detailing the industrial miracle by which Hitler's scientists kept his war machine rolling on synthetic fuels. But to the Allied victors, who had all the cheap petroleum they could use, the secrets were of only academic interest; the documents were shipped off to storage in such places as Washington's National Archives, the British Imperial War Museum and even the dusty garages of a few European scientists.

A generation later, the world energy crunch has provided a new perspective—and the German papers have taken on a sudden new urgency. It's widely known, for instance, that the Nazi scientists worked out much of the technology behind today's most sophisticated coal-gasification projects, but there was clearly much more to their work. To find it, three big U.S. energy-using companies are helping to fund a research project at Texas A&M University, where Dr. Richard Wainerdi, a chemical engineer, and a ten-man team are gathering documents from stashes around the world—many of them still in the cartons and leather straps of 1945.

High Hopes: "It's just a matter of time until the price of synthetics will be competitive with products coming out of the ground," says one of Wainerdi's team, Dr. Kurt J. Irgolic. Officials of Union Carbide, Dow Chemical and Diamond Shamrock Corp. are betting he's right; they have agreed to pick up most of the project's \$150,000 cost so far.

To date, Wainerdi's team has uncovered a 6,000-page energy plan far more elaborate than the one that President Carter put together this year. It has found detailed analyses of production costs and descriptions of at least twenty processes for converting German coal to oil, gas and feedstocks to make petrochemicals. One technique turns high-sulfur coal into low-sulfur oil, an obvious environmental advantage. "The Germans were superb," Irgolic said. "In the '30s, any American who was ambitious in organic chemistry was finding some way to spend at least a year studying in Germany."

Industry's final evaluation of Wainerdi's efforts will have to wait several years, but patience could pay. Among those Nazi papers could lurk ideas leading to major new processes and sources of energy. What intrigues the researchers is that there might be some leads that the Germans, for lack of technology or resources, couldn't pursue—but that might be fully practical today.

PF: Friedman

MEETING WITH MILTON FRIEDMAN

6/9/77

Attendees:

Hugh Malone
Clark Gruening
Pat Rhodey
Brian Rogers
Jim Rhode
Judy Brogan
Jim Edenso
Norman Bailey
Joan Bailey

Malone: Constitutional amendment to set up alternate way for State to use oil money. Better ways for State to use money than expanding government.

- 1) Alaska Inc.
- 2) Diversify state economy
- 3) Opportunities for private enterprise
- 4) Long-run generation of earnings on fund itself to lower taxes

Friedman: Distribute rights to capital sums. Let individuals decide how to spend. Second-best approach, don't allow money to go for current government spending. Limit total state spending as a fraction of income. Legislators would be under less pressure from individual lobbies. This would give an excuse for them to turn down those who want money for their pet project.

Gruening: How do you set the percentage?

Friedman: No natural percentage. Set something going and stick to it. Expending during fiscal year, state spending percentage of personal income of citizens in three prior calendar years equals 20 percent. That would be the ceiling for the next year. Creates a ceiling automatically adjusted for inflation. If public wants to, they can raise it. Let people vote on the budget as a whole in this way.

Rogers: The three-year boom would affect spending.

Friedman: Personal income would adjust this. Don't use state gross product. Other device: Limit equals per capita spending for prior year adjusted for inflation. It is more stringent than the 20 percent. Most government spending doesn't get you what you spend. Percentage limit easier to sell. Using the permanent fund to diversify the economy will dissipate the fund. World Bank approach hasn't helped participating countries.

Malone: What is the approach and structure that would allow the greatest benefits to the people?

Friedman: Write individual checks to the people. You may borrow from the fund; percentage of your original entitlement. Each individual (co-owner of the fund) to invest as he wants. Interest rate would have to correspond to the interest rate of the rest of the fund. Need collateral. In outlying areas, there may be no investment opportunities. Find one or move out. For example, the amount of money spent to put TV into bush communities, if the people had had the money to spend in any way they wanted, they probably wouldn't use it for TV. There may be someone who does have an idea. Collateralize with the physical facility to be built. The only criteria should be that the applicant has to indicate what the physical facility would be and that would be the collateral, that is, beyond his eligibility. The project would have to provide some kind of collateral. Practical difficulty is with people leaving the state. Dividends, absentee owners could withdraw with collateral itself. Pay back or lose dividend. Investing in income-producing entity. If these monies flow into the general fund, they are absorbed into general expenditures. If you said this money had to be returned to the people, it should be.

Gruening: Should Alaska Inc. be tied to the permanent fund?

Friedman: Segregate temporary source so it will provide permanent income. Create permanent income stream.

Gruening: State owns mineral wealth, so money flows into the State. State has a problem diverting this back into state economy.

Friedman: Pro rata shares to citizens. Stay away from ethical question. Search for justice is going to destroy the world. How to handle this for greatest development of resources of the people of Alaska?

Rhodey: Insure private enterprise in the future. Sock the money away.

Friedman: How does that assure private enterprise in the future? Base entitlement in residency length in the state. Anything but giving it to current residents is going to subsidize growth. The ownership of resources is a form of socialism. Oil and mineral resources probably not finite. Real issue is drastic decline in the price of oil. If an individual would rather work here than somewhere else, businesses will be attracted here. If not, why should some be taxed and some subsidized? Value judgments not the issue--it is not wanting to face result of policies. Value judgments will dissipate the fund. Pressure to invest in Alaska is enormous. Meet the political pressure by allowing the people to have their amount of money. Who would choose which businesses to subsidize? Element of loss distinguishes private from public. How cheap to produce at the margin? How expensive not to sell it now? Arabs justify high prices by saying that

oil is finite. Not so, it is because they cannot hold the price of oil up indefinitely. Require the state university to charge full tuition, exactly what it costs the State to educate each student. Subsidy should be through voucher system. Higher income group is being subsidized to the tune of \$100,000,000. Analogous to underdeveloped countries spending for foreign aid. Meet political pressure with alternative scheme to preserve value of the fund. Fund could be used as leverage. Can't guarantee stability during change. Minimize by making it easy to establish other enterprises, money to get through the transition. The most wasteful expenditure is to guarantee jobs in the failing industry. Self-interest is first, but people try to be rational. Closer self-interest is to them directly--the better they do.