More importantly, migration provides many Mexicans with a means of improving their standard of living with relatively little expense to the host country. According to one study, while 70% of migrants contributed to Social Security, federal income taxes, or hospitalization insurance, only 27% used hospitals, 4% had children in U.S. schools, and 1% used food stamps. This suggests that the costs in social services of illegal migrant workers might not be high in comparison to what they contribute (Across the Board, 3-82, pp. 54; Alisky, 1981).

The United States does have limits to the number of migrants who can be assimilated into the work force. With high unemployment among American citizens, members of Congress are calling for a halt to illegal migrant labor, claiming the U.S. economy can no longer support the influx. Proposed new restrictions in Congress include worker identification cards and penalties for Americans who hire illegal aliens. If these proposals pass without some corresponding "guest worker" increase for Mexican migrant labor, the consequences for Mexico could be catastrophic. Unemployment and poverty would rise, increasing the likelihood that the poor would revolt and destabilize the Mexican government (Chr. Sci. Mon., 6-17-82, p. 3).

The Dean Rusk Center was established in 1977 to foster interdisciplinary research, service, and education concerning trade and investment. U.S. fiscal and monetary policy has been a major focus of Center study because of its increasing impact on international commerce. Other areas of concern include international political and military relations and various types of social and cultural exchanges. The Center recognizes, however, that the internal affairs of nations remain the major determinant of international relations and that domestic concerns about the value of the society, its social dynamics, and the availability of resources will continue to vie for dominance in determining a nation's posture in world affairs. Thus, much of the Center's work dwells on domestic events and different disciplinary explanations of their presence and evolution.

Admittedly, the interactions of fiscal and monetary policy, international arrangements, and domestic events cannot be fully analyzed in a specific geographic or subject context. Nevertheless, many of the Center's policy development activities concentrate on the North American region and on related subjects of agriculture, national development, business-government relations, and public governance. Those biweekly "briefings" reflect the convergence of the Center's diverse activities and interests.

Facts and details of events addressed in Briefings are gathered through a scanning of major daily newspapers and weekly periodicals, which are cited throughout each article. Sources of related policy and disciplinary material appear in a listing following each article. The purpose is to link facts with policy implications and academic points of view in order to present an integrated and in-depth approach to current issues. Views expressed are not necessarily those of the Rusk Center.

I. FISCAL AND MONETARY POLICY

FISCAL - THE NEW TAX BILL AND OTHER TAXING STRATEGIES

The recent tax increase bill and spending cuts enacted by Congress indicate that the Reagan administration is not dogmatically wedded to a tax-cutting ideology and appears to be cognizant of changing economic and political realities. To obtain passage of the bills in the House of Representatives, President Reagan had to garner the support of his habitual opponents against his natural supporters. What may be more amazing is that this bipartisan coalition — with conservatives, moderates, and liberals of both parties joining forces — has raised taxes just 10 weeks before an election. Whether this signals a new fiscal discipline in Congress is unclear, but it does suggest that many on Capitol Hill are cognizant of the pervasive business and public perception that the federal budget deficit must come down. The "supply side" underpinnings to the 1981 tax cuts have not brought about a speedy upturn in economic activity and consequent reduction in unemployment. The passage of the new tax bill by itself may do little to restore vibrant economic growth, but it has given the financial community reassurance of the government's ability and willingness to adopt more orthodox economic management policies (Economist, 6-20-82, p. 14; Chr. Sci. Mon., 6-20-82, pp. 14; 6-23-82, pp. 14; Int'l Herald Tribune, 6-11-82, p. 3).

In all, the measures aim to reduce the deficit by approximately $130 billion over the next three years. The tax increase bill is estimated to raise $98.3 billion in additional revenues, with the remaining $31 billion coming from cutting expenditures for dairy price supports, food stamps, Medicaid, Medicare, and cost-of-living increases in civil service and military pensions. The tax bill does not tamper with overall tax rates, leaving in place the 10% personal tax cut scheduled for next July. In essence, it is a hodgepodge of measures that raise revenues by narrowing special tax breaks, tracking unreported income, tightening rules, and levying new taxes. Half the extra revenues are estimated to come from business, one-third from stricter enforcement, and
the remainder from new excise taxes. Ironically, the diffuse nature of the bill may have assisted its passage, contrary to prevailing opinion among corporate lobbyists that a bill attacking so many specific interests would not succeed. In order to gain maximum congressional backing and reduce serious partisan attack, supporters touted the measure as being mostly a matter of closing tax loopholes and increasing taxpayer compliance. Senate Finance Committee Chairman Robert Dole (R-Kan.) sees the bill not as a tax increase but as a means to improve the equity of the tax system, broaden the tax base, and reduce or eliminate obsolete incentives. As such, it does not repudiate the basic thrust of the Roth-Kemp tax cut plan enacted last year; and the savings and Investment Incentives necessary for economic growth are preserved (N.Y. Times, 8-15-82, p. E23; 8-23-82, p. 14; 8-14-82, p. 1; Nat'l J., 7-31-82, p. 137; J. of Commerce, 8-6-82, p. 5A.)

Notwithstanding political rhetoric, the new tax bill will have a substantial impact on both money management and business decisions. The bill reverses the trend in recent revenue legislation of reducing the corporate share of the nation's tax burden; the tax increases may cancel as much as 45% of the tax breaks enacted last year for the business sector. The provisions with the greatest impact for the most companies will be those restricting tax benefits for investment. The act repeals last year's increases in depreciation allowances and reduces Investment tax credits. The controversial maneuver by which firms sell excess tax benefits from investment to other companies through leasing deals will be scaled back and repealed after September 1985. Multinational oil companies will be affected by limits placed on their ability to shelter foreign earnings from U.S. taxation. Defense companies with long-term contracts must tighten their accounting procedures. Drug companies operating in Puerto Rico have had limits imposed on their tax credits, and the insurance industry's tax liabilities will increase with tougher life insurance and annuity rules. Local governments will be affected by more restrictive rules on tax-exempt industrial bonds (U.S. News & World Report, 8-2-82, p. 44; Nat'l J., 7-31-82, p. 137; N.Y. Times, 8-23-82, pp. 14.)

At the personal level excise taxes on cigarettes, telephone calls, and airline tickets have been raised, tax deductions for medical bills reduced, and limits placed on casualty losses. In addition, taxes will be withheld on dividend and interest income, a move expected to net $4 billion a year from previously unreported income. The IRS now has more power to penalize illegal tax shelters and can take other stricter enforcement measures to make tax avoidance more difficult (N.Y. Times, 8-15-82, p. E23; Economist 8-26-82, p. 17; U.S. News & World Report, 8-2-82, p. 44).

While projections have been made as to the likely revenue-raising capacity of each measure in the new bill, the overall complexity of the tax system (together with the ingenuity of taxpayers in finding new ways to shelter income) makes most projections suspect. Even more problematic are the longer-term multiplier effects throughout the economy and on particular sectors. Studies here and in Europe have found that as the public sector grows, increasingly major problems are associated with both the application and the interpretation of new laws, leading to numerous unanticipated side effects. To reduce the negative impact on affected sectors, Congress applied excise taxes to products with low price elasticity of demand (with the possible exception of airline tickets). The curtailment of depreciation allowances and investment tax credits, however, may have pronounced economic ramifications.

A report published in Britain in 1978, in line with similar published works in West Germany and France, found that for maximum revenue-raising efficiency and minimum economic distortion, increasing reliance should be placed on taxing expenditures rather than income. The U.S. has so far rejected this approach. Among member nations of the Organization of Economic Cooperation and Development (OECD), U.S. taxes on corporate income as a percent of total tax revenue are second only to those in Japan. Although some thought and discussion has been devoted to the concept of a value added tax (VAT), little progress has been made toward instituting one in the U.S. Advantages of an expenditure tax include simplicity of operation and reduced scope for avoidance.
The United States relies heavily on income-based taxes with a plethora of exceptions and deductions that are changed or amended with regular monotony. The more frequent the changes, the higher the compliance costs to both firms and individuals and the greater the uncertainty in planning for savings and investment. A strong case can be made for governments to restrict the frequency of changes in tax rates and possible exceptions. The present tax bill's partial aim to reduce loopholes and eliminate obsolete incentive programs may represent a move in the direction of a simplified, more equitable tax structure, but it appears clear that a more fundamental system of reforms is necessary. (Peacock et al., 1981; Pierson, 1980; Natl. J., 7-31-82, p. 1337).

Congress has enacted tax increases and spending reductions in response to the dictates of its own June budget resolution. It has now reached its tax increase goals, but major decisions still remain with regard to spending cuts. Moreover, Congress has done little to slow automatic increases in entitlement programs — a need for which bipartisan political support is unlikely to be forthcoming. This has led some to look further toward expenditure taxes that could enhance economic efficiency and overcome political obstacles to tax improvements. Oil severance taxes have been given as one such example to achieve this end (Weitzel, 1980; Bergston, 1982; Capra & Book, 1981/82; Natl. J., 8-21-82, pp. 1451-).

II. INTERNATIONAL ARRANGEMENTS

ECONOMIC/COMMERCIAL - FOREIGN INVESTMENT IN THE U.S.

In 1981 foreign corporations and individuals spent $19.2 billion to establish and acquire businesses in the U.S., up 57% from 1980. The rate of direct investment in 1982 has been much slower; yet foreign investment continues to play an important role in the U.S. economy. Many foreign firms investing in American business, particularly in the manufacturing sector, prefer to buy existing U.S. facilities rather than build new ones. Although this type of investment often produces benefits for both the involved firms and the U.S. economy, in general, the magnitude of foreign investment and the practices commonly used in acquiring U.S. firms can produce serious economic distortions, particularly in the capital markets (J. of Commerce, 8-3-82, p. 23B; N.Y. Times, 7-10-82, p. 31).

While foreign investment in the U.S. is increasing, American overseas investment is on the decline, particularly in Western Europe. The recession, combined with high taxes and labor costs, is partly responsible. Another contributing factor is the inability of U.S. corporations to compete with government-subsidized domestic companies in the European Economic Community (EEC). European governments of one time were so eager to attract U.S. investors that they offered them advantages at the expense of local industry. Now, seeing the need to readjust the balance in order to protect domestic production, governments are removing those advantages and instead placing restrictions on foreign operations (Wall St. J., 8-12-82, pp. 14).

U.S. state governments now offering large incentive packages to foreign investors should note the European experience. During the past two years, two-thirds of the states have opened offices abroad to attract investment, and local communities are also beginning to compete for foreign capital. While states and localities may benefit in the short-term from an infusion of foreign capital, in the long run...
Incentives to foreign investors can place domestic corporations at a serious competitive disadvantage (Hearings, 1980:14-28).

The official position of the federal government toward foreign investment is one of neutrality. That is, federal law ideally discriminates neither for nor against foreign activities in the U.S., though some restrictions do pertain, such as those related to national security concerns in the manufacturing sector and disclosure requirements for taxation purposes (N.Y. Times, 7-11-82, pp. IF; Weiss, 1980; Hearings, 1980:14-28).

A frequently stated concern over foreign investment in the U.S. is that the country may lose control of significant portions of its economy as more firms come under foreign control. A recent study shows, however, that U.S. firms acquired by foreign investors are rarely placed under tight restrictions by their new owners. In fact, most executives interviewed said their operating autonomy was greater with a foreign parent corporation than it would be with an American one (J. of Commerce, 7-14-82, p. 4A).

Foreign investment following current patterns produces important economic benefits for the U.S. When acquiring U.S. firms, foreign purchasers typically buy weaker, less productive companies and provide them with an infusion of capital and technology. Foreign acquisition thus adds to the supply of capital devoted to productive investment. Because the firms can perform more effectively, they contribute to economic growth. In addition, the economy benefits from a new managerial perspective in that foreign corporate executives tend to a longer-term growth approach to management rather than the short-term profit orientation of most U.S. firms (J. of Commerce, 7-14-82, p. 4A; Little, 1981; Severiens, 1982).

Foreign investment is likely to have its most detrimental effect in the capital markets. Investment is generally highest when interest rates are low and the dollar weak against other currencies because foreign investors can then buy more with their own capital and also borrow at low cost. Foreign purchasers frequently finance their acquisitions by borrowing as much as possible through another U.S. company they have acquired, making interest expenses tax deductible. These built-in incentives to increased foreign activity in U.S. capital markets could result in serious distortions. If interest rates decline significantly, more investors will be attracted to the U.S. to compete with American firms for capital. As demand begins to exceed the capital supply, interest rates will rise once again. The situation could be exacerbated by the slowing of U.S. investment overseas as domestic companies also turn their attention to their U.S. operations (Coo, 1980).

Foreign investment is a mixed blessing. While acquisition of U.S. firms can improve economic growth under certain conditions, problems arise if foreign firms avoid bringing new capital into the economy and instead concentrate on borrowing from the existing capital supply. In addition, the state-level policy of providing huge incentives for foreign business may have the result of placing domestic firms at a competitive disadvantage, leading to restrictions on and lower levels of foreign investment in the future.


III. DOMESTIC ISSUES

RESOURCES - PUBLIC AND PRIVATE REINDUSTRIALIZATION

American industry has weathered the recession with difficulty. After being wreaked by the effects of increases in energy costs, inflation and interest rates, and foreign competition over the last several years, firms are now doing what they can to survive. The U.S. steel industry has recently begun to receive protection against heavily-subsidized foreign steel imports. In June the government announced a policy requiring importers of foreign steel to pay a surcharge equal to the dollar amount of the subsidy, possibly as much as $250 per ton. Although the U.S. steel industry, currently operating below 50% capacity, blames foreign competition for its problems, opposing opinion is that the industry is representative of the overall deterioration in U.S. industrial production. As declining industries look to the government to remedy their situation through such policies as protectionism, the U.S. industrial base remains to be modernized so that American companies can compete successfully at home and abroad (U.S. News & World Report, 6-21-82, p. 54; Zucker et al., 1981).

Since the early 1970s, the U.S. has experienced production losses of $12 billion and seven million industrial jobs permanently eliminated. To rebuild U.S. productive capacity, changes must occur in economic policymaking to create new confidence in American business that will lead to growth in capital investment, innovation, and exports. Bailing out financially troubled industries or attempting to solve their problems through protectionism will not be enough. Needed instead is a consensus among the major parties in the industrial process over appropriate goals for the reindustrialization of America (Bolling & Bowles, 1982; Zucker et al., 1982).

U.S. businesses have reacted to the recession by cutting expenditures on research into long-term projects and have failed to recognize the necessity, even in financially difficult times, of capital investment to ensure future industrial growth. Actually, industries are caught in a destructive cycle: the recession has led to low productivity; low productivity produces little profit for investment; and no investment means no growth. Treasury Secretary Donald Regan attempted to convince American industry that capital spending and investment would promote growth. However, despite $152.8 billion in business tax cuts passed in 1981, industries have shown minimal interest in capital investment (Time, 5-17-82, p. 56; Bolling & Bowles, 1982).

Both public and private sectors recognize the need for reindustrialization, but factions do not agree on how best to bring it about. Continuing that a major hindrance to capital formation is federal safety and regulatory policies, the private sector is quick to blame government for the state of U.S. industry. Cost estimates of business compliance with federal regulations exceed $100 billion — enough to have a major impact on production and investment. Contradictory policies also confuse and cost American businesses. For example, while the Environmental Protection Agency tries to enforce strict pollution regulations, the Energy Department encourages businesses to switch from imported oil to more environmentally harmful coal (Zucker et al., 1982).

However, U.S. industries have not made consistently wise decisions either. Their orientation toward short-term goals rather than long-term planning has been particularly harmful. Automakers provide a salient example of an industry without a long-term strategy. Having failed in the timely creation of a fuel-efficient automobile, they are losing a large portion of the domestic market to foreign competitors. Rather than concentrating on achieving the overall long-term benefits of producing a better automobile, the auto industry has spent its energies and resources battling union leaders and arguing with the federal government over environmental requirements for cars (Bolling & Bowles, 1982; Zucker et al., 1982). As demonstrated by steel and auto manufacturers, when industries do find themselves in financial trouble, they are quick to ask for government assistance.

Some believe the first step to take in reversing the decline of U.S. industry is to combine the leadership of government, labor, and
managers to form a consensus policy representing perceptions from each viewpoint. While competition should remain a cornerstone of the American economy, the levels of antagonism sometimes reached between labor and management or management and government are harmful to all parties. In joining forces to work out a national industrial policy, they may discover avenues to pursue that are ultimately beneficial to all. Such problems as wage limitations, job creation, investment in capital infrastructure, and effective deregulation are much more likely to be resolved through cooperative efforts (Reich, 1982; Muller, 1980).

One proposal for leading the country through a program of reindustrialization and the formation of industrial policy is that an independent economic commission be created to offer recommendations for change. Composed of leaders from government, business, and labor, this national industrial development board would serve three main functions:

1. setting the agenda for reindustrialization, beginning with an analysis of all federal programs affecting development and making recommendations to Congress on equity and efficiency trade-offs;

2. acting as an early-warning system to inform policymakers of changes in the international economy; and

3. performing cost-benefit analyses regarding government decisions on subsidies and regulation (Bolling & Bowles, 1982; Muller, 1980; Zucker et al., 1982).

The main arguments arising in the process of industrial change, however, will probably be over decisions about which industries receive economic support. Government involvement, whether under guidance of an independent commission or on recommendations from Congress, can take the form either of subsidizing industries past their prime or supporting the development of new ones. If reindustrialization is to be successful, industrial policy must distinguish between those industries likely to be competitive internationally and those destined to further decline. Although public support among some groups in the older industrial regions is strong to the contrary, reindustrialization must not be interpreted as a kind of socialism through which dying industries are kept alive at a high cost to the entire national economy (Bus. Wk., 6-30-82, p. 56; Muller, 1980; Zucker et al., 1982).

As states watch the failure of their local industries and the consequent erosion of the tax base, many are eager to see the development of high-technology replacement industries. Recognizing the advantages high technology has brought to the Boston area and to California's Silicon Valley, many states are anxious to recreate these successes. California now provides $22 million in subsidies to high-technology firms. What interested states must realize is that high-technology production demands financial, scientific, and intellectual infrastructure in the form of local venture capital, close ties with nearby universities, and the ability to attract the best engineers (N.Y. Times, 8-8-82, p. 14; Reich, 1982).

Although the Reagan administration does not at present have a precise plan for reindustrialization, efforts at deregulation are a vital starting point. The administration has saved businesses $15 billion in one-time and recurring costs by changing regulatory policies (Bus. Wk., 8-23-82, p. 24). Once the government eases regulations, it becomes incumbent on industry to participate in capital formation beneficial to long-term strategic considerations. The overall success of reindustrialization, however, will depend on cooperation among the private business sector, labor leaders, and the government.


