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The Dean Rusk Center was established in 1977 to foster interdisciplinary research, service and education concerning institutions and processes basic to efficient intercourse among nations. U.S. fiscal and monetary policy has separate emphasis, due to its increasing impact upon international commerce. U.S. trade and investment in a world environment remains the primary focus of its study and policy recommendations sponsored by state and federal entities. The Center also recognizes that internal dynamics of nations remain the major determinant of international relations and that domestic concerns about the quality of life, stability and efficiency will continue to vie for dominance in determining a nation's posture in world affairs. Thus, much of the Center's data collection and analysis dwells on domestic events of nations and diverse disciplinary explanations of their presence and evolution.

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

A. FISCAL - CONGRESSIONAL BUDGET ANALYSIS

On February 8, 1982, the Reagan administration submitted its fiscal year 1983 (FY83) budget proposal to Congress. Next year's fiscal plan thus began the long and politically treacherous quest for approval this September. As a first step in the process, House and Senate budget committees must report budget resolutions which include total levels of revenues, budget authority, expenditures, and debt, and the amount of surplus or deficit. Though this first resolution establishes only general targets for further congressional action, it does set the parameters of debate (N.Y. Times, 3-27-82, p. 25; Nation's Cities Wkly., 2-15-82, pp. 1 & 12; Congressional Wkly. Report, 2-15-82, pp. 223-77).

The FY83 plan encountered almost immediate difficulties. The Congressional Budget Office (CBO), which each year analyzes the administration's budget using its own economic assumptions and techniques, substantively disagreed with the projections prepared by the president's Office of Management and Budget (OMB). Testifying before the Senate Appropriations Committee on February 25, CBO Director Alan R. dello estimated that the government would have lower revenues and higher expenditures than had been projected by the administration. Her office's study concluded that the Reagan budget would produce a deficit of $121 billion in FY83 and that by FY85 the red ink would grow to $140 billion. The OMB had projected a FY83 deficit of $91.5 billion.

The large discrepancies between the OMB's and the CBO's aggregate projections derive from differing estimates of income from sources such as offshore leasing (OMB, $18 billion; CBO, $12.8 billion), from the CBO's belief that government expenditures will exceed the OMB's expectations by about $70 billion, and from the CBO's more pessimistic forecasts of the economy's performance in general-assumptions which add $44 billion to anticipated deficits during FY83-FY85. With great import for the eventual fate of the administration's budget request, the Senate
Budget Committee voted 13 to 1 to accept the economic projections of the CBO, thus rejecting the president's more optimistic figures (Congressional Qtrly. Wkly. Rep. 2, 27-82, pp. 497-496; Wall St. J., 3-31-82, p. 4; Chr. Scit. Mon., 3-1-82, p. 1).

In years past, official forecasts of such economic indicators as changes in GNP or unemployment, which underlie the budget's bottom line calculations of revenues and expenditures, were the sole purview of the executive branch. The president's Council of Economic Advisors and the OMB prepared estimates of the country's economic future which, when considered with requests for appropriations and taxes, determined whether the government could expect to operate in the red or black. Private sector analysts might question the prognostications, but such challenges were often tainted by the suspicion of more than a little self-interest. Lacking the requisite technical expertise or the appropriate staff, individual legislators could ill afford the costs of either preparing their own forecasts or determining the validity of private sector estimates. Inevitably, the official administration assumptions ruled and informed the congressional debate (Boozman, 1979, pp. 215-40).

Reacting to alleged Nixon administration spending abuses, Congress passed the Budget and Impoundment Control Act in 1974, which among other provisions established the Congressional Budget Office (CBO) to provide expert analysis of the president's budget and accompanying data. Concurrently, congressional support staff continued to expand. Legislative employees, both personal and committee staff, increased from about 1,250 during the 1920s to almost 11,000 by 1975. More than 20,000 additional personnel provide information support to Congress through such units as the Congressional Research Service, the General Accounting Office, and the CBO (Heclo, 1977).

Wall Street and congressional opponents greeted with skepticism President Reagan's FY83 budget and its underlying assumptions about the performance of the economy. This negative reaction was considerably exacerbated by budget director David Stockman's earlier admission to a Washington Post editor that "the administration's own budget numbers were constructed on...shaky premises" (Atlantic Monthly, 12-81, p. 38).

Having recognized the power of information and having taken steps in the early 1970s to redress its shortcomings in the acquisition and analysis of data, the legislative branch now finds itself armed with the information needed to execute its responsibility for determining fiscal policy. This change in the balance of power between the branches of government will have a significant and continuing impact on the formulation of fiscal policy even as the administration has sought to reduce government funding for the collection of data on potentially relevant social indicators (Newsweek, 4-5-82, pp. 174; 4-12-82, p. 22; Wash. Post, 6-29-81, p. 1).


II. INTERNATIONAL ARRANGEMENTS

A. ECONOMIC/COMMERCIAL - THE DIAMOND INDUSTRY

The mystique surrounding diamonds also envelopes one of the world's most enduring and successful cartels. De Beers and its marketing arm, the Central Selling Organization (CSO) based in London, markets 80% of the world's rough-cut diamonds. But this secretive cartel arrangement has run into difficulty in the past year. In February De Beers reluctantly concluded an agreement with Consolidated Mining and Smelting of Australia (CRA), the joint venture developing the world's largest diamond mine in western Australia. Unlike past agreements with other diamond producers, this one did not give the CSO exclusive rights to market CRA's entire output.
De Beers was forced accept this arrangement because of the sheer size of the Ashton mine, which, when it reaches capacity in 1985, will add 40% to the world diamond output. The concession comes only 10 months after Zaire, the world's largest diamond producer, ended its marketing agreement with the CSO and began selling its main industrial stones on its own. Thus far, the break has not hurt the Zairen industry, which sold a 14 million carat output to Belgian and Indian buyers (Wall St. J., 2-22-82, p. 27; Bus. Wk., 3-22-82, p. 43; Economist, 10-24-81, p. 66, 1-25-82; p. 64; 2-27-82, p. 70).

Other factors are causing De Beers' control of the market to become more tenuous. Botswana, with an eye on Zaire's successful experiment, has begun to question the workings of the CSO. Increasing pressure for the independence of Namibia is also causing strains on the cartel. De Beers' marketing philosophy over the last 50 years has been to maintain absolute control over supply. The chairman, Harry Oppenheimer, even concluded an agreement with the Soviet Union in the mid-1960s to market their industrial grade stones. But now several sources of diamonds outside CSO's control could flood the market. Israel, a major diamond cutting center, has a major stockpile which, if placed on the world market, could cause a significant price decline. Other cutting centers, such as India, may also challenge the distribution system of the CSO (Atlantic Monthly, 2-82, pp. 23-34).

Not only is the market structure undergoing a metamorphosis, but market demand has been sluggish for nearly two years. Total CSO sales of uncut diamonds fell by 40% last year to $1.47 billion; and in order to maintain prices, De Beers has been stockpiling heavily. It has cut output of its own mines by 5-10% to about 14 million carats, but the diamond mountain continues to grow. For the first time in 12 years De Beers is having to borrow money to support the market. In most countries demand has been weakest for jewel-quality stones. General retail sales in the U.S. rose 8% in 1981, but retail stocks are said to be particularly high. What concerns De Beers more than anything is that the overwhelming majority of diamonds ever cut into jewels still exist. Over 500 million carats are estimated to be in the public's hands. If these start to come back onto the market, the fall in prices would be catastrophic (Economist, 1-16-82, p. 60; 1-16-82, p. 60; Bus. Wk., 9-21-81, pp. 341; Wall St. J., 1-15-82, p. 34; Atlantic Monthly, 2-82, p. 23-34).

What has made the diamond cartel so enduring has been the ability of De Beers to control supply and demand. The cartel operated with such effectiveness that speculators, believing that diamonds go only up in value, regularly bought diamonds as a hedge against inflation. In the early 1930s De Beers embarked on a highly successful advertising and promotional campaign that spawned a new psychological trend in advertising. Rather than promoting a product or brand name per se, the company promoted an idea. It created an image associated with love and longevity and endowed diamonds with a sentiment inhibiting public resale. Even in such a tradition-bound culture as Japan, De Beers' advertising had phenomenal success. By 1981, some 60% of Japanese brides wore diamonds. Its latest marketing aim is to encourage the wearing of diamonds by the conservative British male to match the practice in America, where one in four men is said to own a diamond (Atlantic Monthly, 2-82, p. 23-34; Economist, 1-16-82, p. 60).

Despite the mounting problems of the CSO, it is premature to predict the demise of the cartel. The organization's hold over the marketing of gem-quality stones is still strong, with the better-quality ones still coming from southern Africa. The cartel is, however, facing one of its biggest challenges. The resource minister of western Australia has said the agreement with De Beers is only temporary, and many Australians are opposed to marketing domestic diamonds through a South African concern. Also, the Australian government would like to see a cutting industry develop in Perth, leading many analysts to predict that by 1990 Ashton mine will market its entire output independently. Because so much of the diamond trade is shrouded in secrecy, De Beers' future strategy is difficult to predict. The market has been more volatile in recent years, partly because De Beers deals only in rough diamonds. Some suggestions have been made that the company might move into cutting and polishing, an action which could remove the autonomy
traditional diamond centers such as Antwerp and Tel Aviv have begun to
enjoy. Even as direct competition appears more likely, all diamond
producers remain aware of their strong common interest in not flooding a
market dependent not only on the notion of scarcity, but also on the
whims of human emotions (Economist, 10-24-81, p. 66; 2-27-82, p. 70;

June 1981.

"Cartel Extraction and Backstop Entry." F. Melrose. Recherches eco-

"Advertising and Theory of Entry Barriers." J. S. Chubbm. Economia


B. POLITICAL/MILITARY - AMERICAN MILITARY POLICY

Fundamental changes in U.S. military policy are occurring at the
behest of a conservative administration as it reviews strategic doctrine
and military planning under strong pressure to exercise budgetary con-
straints. The process will be continued after the FY83 defense budget is
passed, because the president has committed himself to a defense buildup
in the wake of the perceived failure of détente with the Soviet Union.
On March 22, a Senate armed services subcommittee rejected President
Reagan's plan for placing 40 MX missiles in existing missile silos,
which he offered as a gesture to conservatives concerned with the vul-
nerability of the nation's intercontinental ballistic missiles. The
subcommittee did not propose an alternative, but declared the president
should produce a long-term basing plan by December 1982 (Congressional
Qtrly. Wkly. Report, 3-27-82, pp. 667). On March 11, a resolution was
proposed by Senator Edward Kennedy (D-Mass.) and Mark Hatfield (R-Ore.),
calling for a verifiable freeze on the testing, manufacture, and deploy-
ment of nuclear weapons by both the United States and the Soviet Union.

Another resolution has been proposed by Henry Jackson (D-Wash.) and
seven other senators urging the administration to negotiate with the
Soviets on a long-term mutual and verifiable nuclear arms freeze at
equal and sharply reduced force levels. The administration is presently
linking Soviet actions in Poland with the progress of Strategic Arms
Reduction Talks (Time, 4-12-82, pp. 121; Congressional Qtrly. Wkly.

Policy input is also being received from members of the executive
branch: General David Jones, chairman of the Joint Chiefs of Staff
(JCS), has proposed that the command structure of the armed forces be
consolidated under the JCS chairman's control to reduce interservice
rivalries that prevent optimal coordination of military planning. Under
this proposal the chairman would be the principal military adviser to
the president and the secretary of defense on the budget, interservice
strategy and operations, and crisis management (Wall St. J., 2-18-82, p. 6).

In all industrialized nations strong pressure exists for decreasing
defense expenditures because economic growth has decelerated while popu-
lar and private-sector expectations remain constant. Defense policy is
therefore partly a product of maneuvering between budgetary constraints
and the requirements of national defense. In the 1970s defense spending
was low compared to the previous decade because the U.S. conducted a
policy of détente with the Soviet Union; investment could thus be
diverted from weapons research and development to commercial sector
investment which offered higher rates of return. Now a fear exists that
the defense industry may not be able to absorb production increases
because facilities are antiquated. The defense industry's structural
defects were made worse during the last decade because a substantial
number of subcontractors went out of business or were bought by con-
tractors. The incentive structure is thought to be deficient, as well,
because the government pays only 80% of what companies are due as pro-
duction proceeds. This practice allows the government to monitor and
regulate costs and encourages companies to meet contract terms quickly
in order to receive full reimbursement; but these benefits came at the
expense of long-term plant improvements, which the policy inhibits. Contracting practices and weapons-financing policies are also being given greater attention: defense expenditures since World War II have been characterized by the inefficiencies of "old boy network" relationships between separate armed forces and contractors which have stifled competition and innovative small business input (Chri. Sci. Mon., 11-98, p. 11; Nat'l. J., 3-7-81, pp. 380; 9-5-81, p. 1572).

Political input into defense policy is experiencing some significant realignments compared to that of the Carter administration. Reagan was given a strong public mandate to rearm and was elected by a coalition that gave him fairly clear-cut choices to define strategic doctrine. On his conservative side are the advocates of "war-fighting" strategy who believe that strategic stability is assured by an ability to launch a first strike against the Soviet Union and to absorb a retaliatory blow while preventing them from doing the same. On his liberal side are the advocates of mutually assured destruction, the basic deterrence posture of the past 20 years, which is based on an assessment of practical nuclear parity between both sides. Another element in the debate over defense policy is a "reform caucus," comprised of Democrats, Republicans, and a few high ranking military officers, which has been developing over the past two congressional sessions. This group is urging that defense budgeting be more subject to efficiency criteria, particularly in the personnel, strategy and tactics, and hardware areas.

If major challenges are advanced against the accepted wisdom of contracting, procurement, and doctrine, then the assumptions upon which policy alternatives are founded are being challenged as well. Though the president bowed to political pressure from Nevada and Utah in deciding not to construct the Multiple Protective Shelters for MX missiles in those states, he may also believe the Russians would be restrained from launching a preemptive strike on the NMD by the inherent uncertainties of doing so and the near inevitability of receiving an unacceptable amount of damage from the other two legs of the strategic triad—bombers and submarines (Atlantic Monthly, 12-81, pp. 14). The criteria of
efficiency and coordination in defense procurement, military planning, and weapons deployment are receiving increased attention, not only by influential military authorities interested in coordinating deterrence and defense among the services, but among moderate and conservative politicians who fear a public backlash against high defense spending. The controversy within the defense community over the efficacy of a predominantly weapons-based strategy versus a strategy based on the deployment of weapons for specific military uses is based on conflicting assumptions. The former postulates the value of firepower for its own sake and of large, autonomous individual services, while the latter places emphasis on the value of a coherent strategy based on military doctrine directly traceable to national political objectives.

The defense buildup will undoubtedly continue. But in contrast to past procurement debates conducted in terms of mutually exclusive economic and military considerations, future discussions will more likely focus on ways to defend the U.S. international position efficiently. Since the national interest is increasingly conceived as encompassing nonmilitary economic spheres, thought will need to be given to defense budgeting that will enable investment to be devoted to such industries as electronics and computers, which are of consequence to the U.S. trade standing, especially vis-a-vis Japan. Other economic realities—for example, the contradiction between a highly centralized defense economy and a decentralized civilian economy—as well as pressure at home and abroad to reduce nuclear arms levels, will probably compel the president to make arms control a central feature in military and security policy (Chri. Sci. Mon., 2-19-82, p. 23; U.S. News & World Report, 9-28-81, p. 24). Whatever the outcome of the U.S. defense budget and military planning battles, military means of preserving strategic stability will remain the predominant context within which all international activity occurs for some time to come.


secularism; a difficult language; an unusual curiosity about the outside world; and a pronounced sense of the aesthetic. At the same time, Japan has adapted to external challenges from Chinese and western societies by borrowing from those cultures to preserve the vital aspects of their own society. By emulating foreigners, the Japanese have distinguished themselves by improving and preserving their cultural heritage and those that underlie it. Western techniques have been used to modernize society rather than westernize it (Reischauer, 1977). Japan's major postwar social achievement has been to wed the values of egalitarianism common to most countries with traditional Japanese demands for a high level of quality in life, including high productivity, high educational standards, social stability, and cultural vitality.

The nature of Japanese society is both responsible for and promoted by the country's enormous economic growth since World War II. The commitment of both management and workers to their corporations in return for job security and retirement benefits has provided employers with important production incentives. Per capita production and productivity is very high in Japan because the social dynamics of production are exploited by companies through the paternalistic treatment of workers and lower-level executives. Worker expectations are dampened and loyalties directed toward the corporation (and, implicitly, toward the nation) by limiting extreme disparities in income between low- and upper classes, thus creating an egalitarian society in a market economy. Government agencies, however, are the final arbiters of economic activity, inasmuch as they directly invest by controlling taxation and by insuring bank loans frequently based on high debt-to-equity ratios.

The Japanese group orientation defines the Japanese world view and lifestyle. Whether loyalty is given to the village, as in the past, or to the university or company today, stability is based on consensus and cooperative decision making and action in nearly every sphere of activity, as well as on a hierarchical order recognizing the superiority of age and seniority. Education provides the context for social ordering; stiff competition to enter universities leads to a scale of elite
gradation that defines the status of people for life but renders them disinclined, because of their guaranteed position in the hierarchy, to aspire to rise above that level. Overlaid on this order are such western elements as scholarly knowledge and technique, parliamentary institutions, technology, high culture, and American popular culture. Traditionalism has influenced the modification of the Japanese political system in a manner contrary to the intentions of Japan's postwar American occupiers. The system includes factional representation in government in addition to a pluralistic system largely dominated by one party, the Liberal Democrats. That the Liberal Democrats have been able to stay in power since 1955 by meeting challenges from parties to the left on its own terms is a testament to the stability of Japanese politics.

Ever-increasing interdependence with the rest of the world has posed significant questions about Japan's self-identity (Reischauer, 1977). Observers wonder if traditional Japan will maintain itself in the face of numerous threats to its integrity—economic uncertainties engendered by heavy dependence on foreign raw materials; the development of nontraditional tastes on a mass scale; pressure from the U.S. to increase Japanese defense capabilities in the western Pacific; and international agitation for the entry of more imports into the Japanese domestic market. Economic growth must continue in order for the post-war social consensus to thrive. Like other developed nations, Japan may feel the effects of affluence, such as a decline in the work ethic and a preference for leisure, neither of which are traditional Japanese characteristics. Anything perceived to threaten Japan could be met with a xenophobic reaction, but without recourse to military means of securing raw materials and markets. Contemporary Japanese society possesses strong links with the past: in the emporer, which provides the requisite symbol for effective politics; in the strong role of business executives, which parallels the decentralizing samurai figures; and in the peculiarly Japanese social order. These social features will be important in the future. Increasingly, knowledge of other nations and cultures through advanced communications and far-flung enterprises not only enables the Japanese to continue the process of adopting some foreign ways while rejecting others, but also enhances their distinctiveness from other peoples, affirming that they are neither western nor eastern. Whether Japan will continue to be able to do this or whether it will be transformed by foreign cultural inputs cannot be known, but the extraordinary resilience of Japanese culture will play a major role in preserving its traditions against the most undesirable effects of modernization.


B. HUMAN DYNAMICS - UNDERGROUND ECONOMY

With an approaching April 15 deadline for filing income taxes, a U.S. appeals court has affirmed the Internal Revenue Service (IRS) crackdown on barter organizations by upholding their summons requiring membership lists and financial records of the Columbus Trade Exchange. This year the IRS expects an $87 billion tax loss on unreported legitimate income; private economists predict a "compliance gap" of $420 billion in unreported income and $95 billion in uncollected taxes (Wall St. J., 3-15-82, p. 48; 4-5-82, pp. 64%; Forbes, 3-29-82, p. 120; N.Y. Times, p. 1).

Barter organizations are a small part of a phenomenon known as the underground economy, equivalent to 10-24% of the GNP. In growth, participants, and origins the two are similar. The trade volume of barter organizations has been estimated at $500 million, double the level of three years ago. Like other activities in the underground economy, the growth rate of barter is higher than that of the regular economy (Forbes, 3-29-82, p. 120). Participants tend to be middle class and
affiliated with small businesses rather than with large corporations. Growth of barter organizations and the underground economy appears to result from rising taxes and declining trust in government.

Two components comprise the underground economy. "Off-book transactions" consist of legal economic activities, income or profits from which are unreported and untaxed. For example, earnings from interest and dividends are often unreported, as are 44% of capital gains on "collectibles," such as gold, antiques, and works of art, according to IRS calculations (Wall St. J., 4-15-82, p. 4D). Many retail firms "skim the till." Some companies in the construction trades and in certain manufacturing industries (e.g., garment making) engage to a considerable degree in unreported cash transactions. Much income from "moonlighting" is unreported. The second component consists of illicit activities involving transport of illegal aliens, prostitution, arms sales, and $45 billion in drug traffic (Bus. Wk., 4-5-82, p. 664).

Some effects of the underground economy are positive. It may serve as a social safety valve, countering cyclical problems such as unemployment and lagging GNP growth by providing jobs that might not otherwise be available. Many small firms could go out of business in today's high-wage, high-cost conditions without the "slack" that off-book transactions build into the system. Similarly, the size of the underground economy might mean that economic recovery will occur faster than anticipated since the underlying economic conditions—GNP level and growth, savings rates, productivity changes, and unemployment levels—are not as bad as reported in official statistics. Indeed, unemployment may be overstated by two percentage points (Bus. Wk., 4-5-82, pp. 644). Finally, the underground economy creates new wealth by making possible the exchange of goods and services that would not be sold in the marketplace. Many of the services traded within barter groups, such as private yoga lessons and proctoderm, could not be offered for sale on a sufficiently large scale to be viable on the market; others, such as chiropractic adjustments, could not be offered at the wholesale prices given through many barter organizations.

However, the underground economy has many deleterious effects. Uncollected tax revenues increase the federal deficit and thus contribute to inflation. Money from illicit trade can have imbalancing effects in certain regions. In south Florida, for example, the flood of "mondo-dollars" has skewed the housing market, not only raising prices on average of $2,000 above the norm, but virtually eliminating construction in all except the highest-income bracket markets. The most important manner in which the underground economy aggravates inflation is through the distortion of macroeconomic indicators used to set fiscal policies. When statistics in 1977 pointed to a coming recession, the Carter administration instituted stimulatory policies. The result was to fan the flames of inflation, since consumer spending was not tapering off. Moreover, because so many reportedly unemployed had sources of income, the response to federal employment programs was poor, the administration's policies seemed a failure, and the legitimacy of the federal role in the economy was undermined.

Another effect of the underground economy, with its many "off-book" workers, is the degradation of the actuarial soundness of the social security system (Int'l. Labour Review, 1974;549-63, Sept/Oct. 1980). In addition, many "underground" workers suffer sweatshop conditions, receiving less than minimum wage, working long hours in unsafe and unhealthful surroundings, hesitating to complain, often because of their status as illegal aliens. In some restaurants and lofts in New York and Los Angeles the treatment of workers is redolent of the worst era of industrialization (Time, 9-7-81, p. 54). Finally, the underground economy may be self-reinforcing. If so, the effect will be an erosion of civic morality with far-reaching, perhaps irreversible, consequences not only for the IRS but for governance in general.

This last effect is revealed in an examination of proposed solutions for dealing with the underground economy. Increased enforcement may be costly for both the IRS and the private sector, particularly if the problem is widespread tax evasion among loss-affluent taxpayers. The Treasury Department plans to release proposed barter club regulations, which will require reports of member lists, records of
transactions, and a valuation of trade credits within the organization. Such reporting could put barter organizations out of business. Both President Reagan's proposal to withhold taxes on dividends and interest and Senator Dole's alternative, requiring brokers to report all customers' transactions, would introduce costly regulations and red tape that has been rejected in recent elections. Moreover, all of these measures would further complicate the tax system, making it less comprehensible to middle- and lower-income citizens who cannot afford to hire tax consultants. Thus, measures designed to increase enforcement could undermine the legitimacy of governance structures and customs in the United States (Wall St. J., 3-15-82, p. 48).

In general, the American income tax system works as well as it does because of a high level of voluntary compliance. If this climate of social morality is eroded by unclear government policies, worker exploitation, the belief that federal economic policies are inept, or the perception that cheating is widespread, then the costs of increased enforcement may offset the gains from increased revenues. An obvious alternative is to lower taxes. Yet many economists doubt that tax reductions would have a dollar-for-dollar impact on unreported income from legal or illegal sources. Switching from an income to a sales or value-added tax would not obsolete the problem either, particularly at the retail sales level.

If the underground economy cannot be brought into the open, then the implications for the future of discretionary fiscal policies is grave. Macroeconomic "fine-tuning" by the government will certainly backfire into inflation and other unanticipated consequences if the statistics upon which it is based continue to be substantially distorted representations of the economy.


IV. NORTH AMERICA

MEETING LDC ENERGY NEEDS - Energy needs of developing countries have been an important if not the primary topic of discussion at several recent international meetings, including the Energy Conference held in Kenya in August, the North-South Summit at Cancun, and the annual meeting of the World Bank. The Bank's new president, A.W. Clausen, has advocated the establishment of a separate energy fund at the Bank to meet the growing energy needs and the oil-related debts of developing nations (Wall St. J., 11-3-81, p. 12). World oil prices have increased fivefold since 1973. During the next two decades most of the increments in oil demand will come from LDCs, whereas that of developed countries will stabilize or level off: LDC demand for oil is expected to rise from 11 to 24 million barrels per day; demand in developed countries is predicted to drop from 66 to 64 million barrels per day. Developed countries are able to reduce oil demand through the use of conservation measures and alternative energy sources. Neither of these methods will reduce the growth in LDC oil needs because their economies already use a low level of energy and because there is no substitute for oil in many infrastructural projects, such as transportation systems, critical to industrialization and growth (N.Y. Times, 10-21-81, p. A1).

The role of North America in meeting these growing energy needs has not yet been clearly established. Recently, Mexico and Venezuela agreed to aid other Caribbean nations by providing oil at reduced prices. The U.S. has opposed the establishment of a separate energy fund, but at Cancun the U.S. position was modified: it would neither oppose such a fund nor contribute to its financing. Canada has for some time pursued a benign image among third world nations as a peacemaker, an advocate of decolonization, and a generous donor. In fact, 80% of Canadian
Helping LDCs meet their energy needs is in the interest of all three North American countries insofar as such help fosters economic growth and the resultant expansion of potential foreign markets for Mexican, Canadian, and American products. Mexico is a logical source of petroleum supplies for development projects, especially in cases where alternative energies cannot be substituted. However, Mexico itself is a developing country which seeks to use its oil riches to generate economic growth, industrialization, and modernization. Canadian and U.S. assistance would fall into the area of energy diversification. Conversely, if North America ignores LDC energy needs, many of these countries may default on their burgeoning debt, while others will turn to other countries or trading blocks, establishing arrangements that may prove hard to penetrate or alter in later years.

While North America is unlikely to turn its back on the energy needs of the LDCs, it is important that assistance be provided in a form which encourages general economic growth and augmented export markets. Programs based on purely altruistic assumptions may not be most beneficial to receiving nations in the long run. Such assumptions are shaky grounds on which to base development projects, particularly in energy diversification: short-term political turmoil may wreak havoc on such good will; and without the prospect of clear economic benefits, such an atmosphere of uncertainty will deter many creditors from making the needed long-term commitment of capital. Moreover, altruistically motivated aid is less likely to be tied to calculations of profitability and resource optimization. Subsidies and other forms of public assistance to weak economic sectors will only serve to harm LDCs in the long-run.


V. EDITORIAL

LAND REFORM - Past scholarly research has shown that political violence and turmoil are strongly related to economic variables such as income distribution and rate of economic growth. As has so often occurred in developing countries, the political structure does not adequately respond to economic realities, with the result that governmental change comes suddenly and violently. One institutional economic factor that has caused much discussion is land tenure and reform. Few matters engender such deep emotion or are so encumbered with political rhetoric.

Reform of land tenure systems together with changes in the institutions surrounding farm production can exert a powerful influence on economic development in agrarian countries. But many past reform efforts have not been successful because the political, sociological, and economic aspects of each case have not been adequately interwoven and recognized. Too often the social arguments for greater equality are so overwhelming that little thought is given to the longer-term economic implications. Much depends upon the type of land tenure in existence prior to reform. In many developing countries, splinter holdings and scattered, fragmented holdings are at least as great a problem as concentration of land ownership in a few hands.
Of the large landholding types, three general forms of tenure may be found. First is the large holding, leased in small units to tenant cultivators and common throughout Asia. Second is the latifundia type of large plantation, where the whole unit acts as one production center and utilizes hired labor inputs. This is common throughout Latin America. The third type may be termed the "corporate plantation," owned by a corporation and operated on an intensive basis, generally for export markets. This type is found in both Latin America and Africa. A feature of all three ownership types is the existence of an institutional monopoly that creates a marked imbalance in income distribution. Furthermore with regard to the first two types, it may be argued that the large concentrated incomes are not reinvested in a socially beneficial manner. Conspicuous consumption of imported luxury items occurs, and other excess income tends to be reinvested in other landholdings or urban dwellings. In other words, the surplus accruing to the landowners does not stimulate local industry or the domestic production of consumer items.

Thus the economic case for reform of land tenure systems can be persuasive. Unfortunately in many land reform experiments, little comprehensive forethought is given to land redistribution programs, with the result that agricultural productivity and output is not sustained. Land tenure changes should seek to encourage greater output, which necessitates an institutional arrangement that retains sufficient flexibility to allow adaptation to technology changes and variations in the relative prices of alternative agricultural outputs. Just changing title to the land will do little to encourage agricultural output and investment if the provision of other complimentary inputs are ignored. Credit, transport, storage, fertilizers, and pesticides are essential; but to new recipients of land they are often unavailable. Furthermore, former tenants and wage workers may not have developed desirable managerial and planning skills, which can materially affect the efficiency of their agricultural efforts. In conjunction with land reform schemes, agricultural extension efforts are much needed.

To view land reform simply as a matter of expropriation and redistribution can be dangerous. Little can be achieved if political and agrarian stability are not forthcoming; and while egalitarian ownership may result, the economic potential can be lost with disastrous results. For example, in Bolivia in 1952 peasant appropriations of large estates immediately reduced production by one-third. A similar experience occurred in Mexico. Clearly, land reform and regularized land title systems are vital conditions for economic development in many countries, but too hastily a program in response to political opportunism may do more harm than good.


