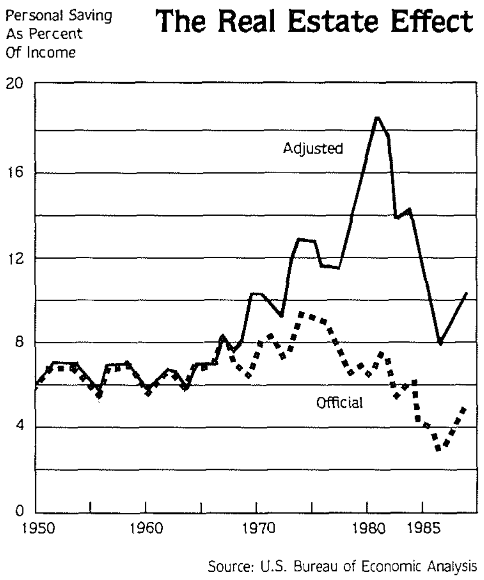

Official statistics show an alarming decline in personal saving since the early 1970s. But making an adjustment for rising returns to homeowners produces a different story.

their nest eggs thus enlarged, homeowners in the 1980s cut their saving out of current income. Because official accounting severely understates the investment return to housing, the authors say, the personal-saving picture looked much worse than it really was.

Once that flaw in the official accounting is corrected, according to Munnell and Cook, it turns out that instead of falling during the late 1970s, personal saving actually surged higher as a result of the larger return to housing. "When the escalation in housing prices ceased... the return to owner-occupied housing regained more normal levels and saving dropped"—but not as far down as the official picture indicates. "The saving rate appears to have dropped back to levels experienced in the 1950s and 1960s rather than to unprecedented lows." This finding seems to represent a verdict of acquittal, on the spendthrift charge at least, for the oft-lambasted "me-generation."

The Other Tax Bill

"Unhappy Returns" by James L. Payne, in *Policy Review* (Winter 1992), 214 Mass. Ave. N.E., Washington, D.C. 20002.

Americans are painfully aware of the toil and trouble that leads up to April 15. Yet Washington seems oblivious. It should not be, contends James Payne, director of Lytton Research & Analysis, in Sandpoint, Idaho. Although the private-sector costs of operating the tax system appear nowhere in the federal budget, he calculates that they are equal to 65 percent of Washington's tax revenue—$618 billion in 1990.

The lion's share of that invisible burden—$315.6 billion, equivalent to 33 percent of all tax revenue—comes, according to Payne's analysis, in the form of production lost because of taxation's economic disincentives. Economists may differ over that amount, but about the fact that *compliance* with the tax system has substantial costs there can be little disagreement.

A nationwide survey in 1985 found that individuals spent 1.8 billion hours and businesses spent 3.6 billion hours keeping records, learning about regulations, making calculations, and filling out forms. Payne figures that the cost of individual compliance that year was more than $57 billion and of business compliance, more than $102 billion. In 1990, he calculates, the total cost of compliance was more than $232 billion.

Legal and illegal attempts to avoid taxes, along with the burdens of litigation and of having to cope with government enforcement efforts, bring the unofficial tax bill still higher, boosting it nearly $65 billion in 1990, according to Payne. That year, the IRS not only conducted 1.2 million audits but also sent out 4.9 million computer-generated letters to taxpayers suspected of underreporting their incomes or failing to file required returns. A General Accounting Office (GAO) study found that such computer notices contained errors nearly half the time.

But it is not only computers that err. "As the U.S. tax system has become both more complex and more insistent in its demands," Payne writes, "individuals and businesses fall by the wayside in keeping up with its demands." Each year, one-third of all U.S. employers are penalized in connection with the payroll tax deposit rules, which are so complicated that even Internal Revenue Service officials apparently don't understand them. The GAO found that 44 percent of the penalties meted out under those rules were wrongly imposed.

Surely, however, simply raising taxes a little should not increase the system's costs. But Payne contends that not only do the economic-disincentive effects go up but so also do the costs of compliance. Higher tax rates provoke increased efforts at tax evasion (legal and illegal), and this prompts policymakers to add still more requirements to the tax code, thus increasing taxpayers' costs as well as their heartburn.

What Is Competitiveness?

"Myths and Realities of U.S. Competitiveness" by Paul A. Krugman, in *Science* (Nov. 8, 1991), American Assoc. for the Advancement of Science, 1333 H St. N.W., Washington, D.C. 20005.

Lately, the nation's herd of policy "experts" has been bleating loudly about the decline of U.S. "competitiveness." Most of them, says Krugman, an MIT economist, do not know what they are talking about.

The worriers raise the specter of an America overcome by foreign economic competition, suffering perpetual trade deficits, catastrophic unemployment, perhaps even virtual bankruptcy. That, however, is highly unlikely. The disaster scenario is based, writes Krugman, on a faulty analogy between competition among businesses and trade among nations. In business, the market is limited, and firms that lose their foothold do go bankrupt; trade, however, is not a zero-sum game in which one nation's gain must be another's loss.

Strong balancing forces normally see to it that any country, even one with poor productivity, technology, and products, can still sell a range of goods in world markets and generally balance its trade over the long run. Such countries can carve out areas of comparative advantage in fields—farm products or textiles, for example—that nations with, say, high wages do not enjoy. In fact, international trade allows less "competitive" countries to *raise* their standard of living. It lets them sell their products in world markets and buy others—be they bon bons or computers—more cheaply than they could make them for themselves.

Lagging productivity growth and technological progress certainly are worth worrying about in their own right, Krugman says, but "the real competitiveness issue" lies elsewhere. It has to do with how U.S. comparative advantage is determined. In theory, the market rules, but recent scholarship shows that history, accident, and, increasingly, government intervention can allow countries to create comparative advantage in new industries. And once such an advantage is established, "it becomes self-reinforcing and tends to persist." There is evidence to suggest, for example, that Japan is trying to develop comparative advantage in the high-technology industries by reserving its home markets for domestic producers: Foreign high-tech firms claimed only six percent of the Japanese market in 1985, the same share as in 1970. In the United States, by contrast, foreign penetration rose from five percent to 16 percent during those years, while in Germany it jumped from 23 percent to 57 percent.

Krugman seems to believe that Japan's actions may deserve a response from Washington, but he is cautious. To begin with, unfair trade practices are not the major source of America's economic woes. In any event, no country can expect to be number one in all areas of economic life. And finally, "competitiveness is one of those issues, like national defense, that can easily be used as a patriotic cloak for special interest politics."