

THE NEED FOR LENGTHENING ECONOMIC
HORIZONS

REMARKS BY MR. ROBERT P. MAYO, PRESIDENT
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TO THE
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I AM PLEASED TO HAVE THE OPPORTUNITY TO MEET WITH YOU THIS EVENING. I FEEL VERY MUCH AT HOME WITH ACCOUNTANTS SINCE I WAS AN ACCOUNTING MAJOR IN COLLEGE. I HASTEN TO ADD, HOWEVER, THAT I DIDN'T GO THROUGH THE RIGORS OF THE CPA EXAM. INSTEAD, I ENDED UP AS AN ECONOMIST.

WITH SOME BACKGROUND IN ACCOUNTING AND IN ECONOMICS, I WAS INTRIGUED BY MR. QUIGGLE'S MENTIONING LAST APRIL THAT THE THEME FOR THIS MEETING WAS "WHAT THE ACCOUNTANT SHOULD KNOW ABOUT ECONOMICS". AS I THOUGHT ABOUT IT, IT OCCURRED TO ME THAT THE ACCOUNTANT KNOWS A GREAT DEAL MORE ABOUT ECONOMICS THAN OTHERS GIVE HIM CREDIT FOR. IN FACT, HE PROBABLY KNOWS A LOT MORE ABOUT ECONOMICS THAN HE GIVES HIMSELF CREDIT FOR.

THERE ARE TWO VERY SIMPLE IDEAS IN ACCOUNTING THAT ALSO LIE AT THE HEART OF ECONOMICS--ESPECIALLY ECONOMIC POLICY DECISIONS. THE FIRST IS THAT WE USE A DOUBLE-ENTRY SYSTEM IN ACCOUNTING AND THE SECOND IS THAT THE BALANCE SHEET IDENTIFIES "STOCKS" AT A POINT IN TIME WHILE THE EARNINGS AND EXPENSE STATEMENT IDENTIFIES "FLOWS" OVER A GIVEN PERIOD OF TIME.

THESE TWO NOTIONS CAN BE PUT TO WORK IN AN ECONOMIC POLICY CONTEXT VERY EASILY. GOOD ECONOMIC POLICIES ARE THOSE THAT CLEARLY RECOGNIZE THAT ACTIONS AFFECT BOTH SIDES OF THE BALANCE SHEET. THE DEEP RECESSION FROM WHICH WE ARE NOW EMERGING AND THE HORRIBLE INFLATION WHICH IS NOW GRADUALLY SUBSIDING ARE UNCOMFORTABLE EXAMPLES THAT WE HAVE GIVEN LESS WEIGHT THAN WE SHOULD HAVE TO THE ESSENCE OF DOUBLE ENTRY ACCOUNTING, OR--WHAT IS THE SAME THING-- TO THE OLD PHRASE DESCRIBING THE BASIS FOR ECONOMICS, "THERE IS NO SUCH THING AS A FREE LUNCH."

THE EXPERIENCE OF THE RECENT PAST HAS ALSO CLEARLY INDICATED THAT IN TRYING TO REACH OUR BALANCE SHEET GOALS FOR THE NATION IN TERMS OF UNEMPLOYMENT WE HAVE NOT ALWAYS PAID ENOUGH ATTENTION TO THE "FLOWS"; THAT IS, WE HAVEN'T FULLY APPRECIATED THAT CURRENT ACTIONS TO REACH OUR GOALS CAN SET IN TRAIN DEVELOPMENTS THAT MAKE IT DIFFICULT TO REACH OUR GOALS LATER.

IN ASSESSING ANY SET OF ECONOMIC POLICIES WE MUST ALWAYS KEEP IN MIND THAT EVENTS IN THE PAST CONTINUE TO AFFECT THE PRESENT AND WILL INFLUENCE THE FUTURE AS WELL. THE SLATE CANNOT BE WIPED CLEAN. WE MUST START WITH WHERE WE ARE AND BE VERY AWARE OF HOW WE ARRIVED THERE. BECAUSE THE U.S. ECONOMY RESPONDS ONLY GRADUALLY OVER TIME TO THE MAJORITY OF FORCES LEADING TO CHANGE, WE MUST TAKE INTO ACCOUNT FORCES ALREADY SET IN MOTION EVEN IF THEIR EFFECTS ARE NOT FULLY APPARENT.

THIS, THEN, IS A MAJOR REASON FOR ARGUING THAT THERE IS A NEED TO LENGTHEN OUR ECONOMIC HORIZONS. BUT THERE IS ALSO ANOTHER

REASON FOR LENGTHENING OUR HORIZONS AND, THAT IS, WE ARE LIVING IN A CHANGED ENVIRONMENT--AN ENVIRONMENT WHERE SUPPLY FACTORS MAKE ECONOMIC POLICY FORMULATIONS AND IMPLEMENTATION AN EVEN MORE DIFFICULT CHALLENGE. I WOULD LIKE TO SHARE WITH YOU SOME OF THE KINDS OF CONSIDERATIONS THAT GO INTO MAKING PUBLIC POLICIES-- IDEAS THAT ARE FREQUENTLY NOT WIDELY DISCUSSED BECAUSE THEY ARE SO BROAD AND ABSTRACT. THE IMPLICATIONS OF SCARCITIES OR SHORTAGES FOR ECONOMIC STABILIZATION POLICIES--AND HERE I MEAN THE USE OF BOTH MONETARY AND FISCAL POLICIES TO ACHIEVE AND MAINTAIN STABLE PRICES AND RELATIVELY FULL EMPLOYMENT--ARE NOT SIMPLY ABSTRACT, THEORETICAL EXERCISES OF CONCERN TO ECONOMISTS AND THE OCCASIONAL POLICY MAKER. IT SEEMS CLEAR TO ME THAT SHORTAGES OF SUPPLY SERVE TO CONSTRAIN OUR ACHIEVABLE ECONOMIC GOALS AT LEAST IN THE SHORT RUN AND THE PUBLIC MUST BE AWARE OF THOSE CONSTRAINTS IF THEY, THE PUBLIC, ARE TO GIVE REALISTIC DIRECTION TO POLICY EFFORTS, TO HAVE REALISTIC EXPECTATIONS OF THE RESULTS THAT CAN BE ACHIEVED AND TO MAKE REALISTIC ASSESSMENTS OF ECONOMIC POLICIES AND ECONOMIC POLICY MAKERS.

UNFORTUNATELY, PUBLIC EXPECTATIONS OF THE PERFORMANCE OF ECONOMIC POLICIES EVEN IN THE ABSENCE OF SCARCITIES HAS BEEN GREATER THAN THOSE POLICIES COULD BE REASONABLY EXPECTED TO ACHIEVE, * ATTRIBUTABLE I AM AFRAID TO POLICY MAKERS AND ECONOMISTS WHO PROMISED MORE THAN THEY WOULD DELIVER. SINCE THE 1930'S THE GOVERNMENT HAS BEEN BROUGHT ACTIVELY TO THE SUPPORT OF ECONOMIC

WELL-BEING, ECONOMIC STABILITY AND ECONOMIC GROWTH. IT HAS BEEN BELIEVED THAT THE "NEW ECONOMICS" WOULD SOLVE OUR PROBLEMS--ALL THAT WAS REQUIRED WAS "GOOD MANAGEMENT". AND WE'VE HAD SOME SUCCESS, BUT ALSO SOME FAILURES OVER THIS PERIOD. TO A SUBSTANTIAL DEGREE, THE DIFFICULTY HAS BEEN THAT OUR EXPECTATIONS FOR THE ECONOMY AND FOR ECONOMIC POLICY HAVE BEEN GREATER THAN THE CAPABILITY TO DELIVER.

THE BASIC EMPHASIS OF POLICY OVER THE PAST FEW DECADES HAS BEEN ON THE MANAGEMENT OF THE DEMAND FOR GOODS AND SERVICES. SUPPLY CONSIDERATIONS HAVE NOT BEEN IGNORED, HOWEVER WE HAVE, FOR EXAMPLE, AFFECTED SUPPLY THROUGH AGRICULTURAL SUPPORT PROGRAMS AND MINIMUM WAGE LEGISLATION EVEN THOUGH SUPPLY EFFECTS MAY NOT HAVE BEEN THE PRIMARY OR SOLE OBJECTIVE OF THESE PROGRAMS. WE HAVE ALSO TAKEN THE EXISTING LIMITS OF CAPACITY GROWTH INTO ACCOUNT IN OUR PLANNING. BUT THE BASIC THRUST AND EMPHASIS HAS BEEN ON INFLUENCING AND AFFECTING PRIVATE AND PUBLIC DEMANDS FOR GOODS AND SERVICES.

AS EVERYONE IN THIS ROOM IS AWARE, EFFORTS HAVE BEEN MADE TO STIMULATE DEMAND WHENEVER WE HAVE HAD AN UNDERUTILIZATION OF OUR HUMAN RESOURCES--LESS THAN FULL EMPLOYMENT. ON THE TOP SIDE OF THE CYCLE, IN ORDER TO REDUCE THE PRESSURES ON PRICES, POLICIES HAVE BEEN DIRECTED TO REDUCING DEMAND WHENEVER OUR RESOURCES ARE FULLY UTILIZED.

IN THIS DIRECT IF SIMPLISTIC VIEW OF STABILIZATION POLICY, IT IS ASSUMED THAT FULL EMPLOYMENT IS POSSIBLE WITHOUT UNACCEPTABLE

PRICE INCREASES. THIS IS SO BECAUSE THE FACTORS OF PRODUCTION OTHER THAN LABOR ARE IDLE OR ASSUMED TO BE CAPABLE OF BEING PROVIDED QUICKLY. THIS MEANS THAT NO SUPPLY CONSTRAINT OR ONLY A LIMITED SUPPLY CONSTRAINT IS PRESUMED TO EXIST. AS LONG AS THIS IS TRUE, WE CAN HAVE SOME SUCCESS THROUGH DEMAND MANAGEMENT POLICIES IN ACHIEVING FULL EMPLOYMENT AND STABLE PRICES.

THE REASONS FOR OUR LACK OF COMPLETE SUCCESS IN FOLLOWING THIS TYPE OF SCENARIO, HIGHLIGHT SOME OF THE DIFFICULTIES THAT ECONOMIC POLICY WILL FACE IN A CHANGED ENVIRONMENT WHERE SUPPLY CONSTRAINTS MAY EXIST. CLEARLY THERE HAVE BEEN A NUMBER OF PERIODS IN OUR HISTORY IN WHICH WE WERE UNWILLING OR UNABLE TO RESTRAIN DEMANDS ON OUR PRODUCTIVE POTENTIAL AND INFLATION RESULTED. YOU WILL RECALL THAT IN THE EARLY 1960'S THE ECONOMY WAS CHARACTERIZED BY STABLE PRICES BUT AN UNEMPLOYMENT RATE OF ABOUT 5 1/2 PERCENT. DEMAND WAS STIMULATED. LATER IN THE DECADE, THE DEMAND OF THE VIETNAM WAR, WITH ITS PRESSURES ON MANPOWER AND OTHER PRODUCTIVE RESOURCES, AND THE INITIATION OF NEW GOVERNMENT SOCIAL PROGRAMS REDUCED THE UNEMPLOYMENT RATE TO 3 1/2 PERCENT BY 1969. AT THE SAME TIME, HOWEVER, INFLATIONARY PRESSURES MOUNTED AND THESE EXPANSIONARY POLICIES SOWED THE SEEDS OF AN INFLATIONARY CYCLE. DURING THIS PERIOD, WE SIMPLY ASKED TOO MUCH FROM THIS ECONOMY IN TERMS OF BOTH PUBLIC AND PRIVATE GOODS. WE DID NOT HEED OUR OWN ESTIMATES OF CAPACITY. TOTAL SUPPLY COULD NOT ADJUST AS RAPIDLY AS DEMANDS INCREASED AND PRICE PRESSURES RESULTED. ALTERNATIVELY WE MIGHT SAY THAT PUBLIC EXPECTATIONS FOR THE

ECONOMY EXCEEDED ITS ABILITY TO DELIVER.

PUBLIC EXPECTATIONS FOR ECONOMIC POLICY HAVE ALSO EXCEEDED THE CAPACITY TO DELIVER AS OUR MORE RECENT INFLATIONARY EXPERIENCES INDICATE. THE UPSURGE IN PRICES IN 1973, '74 AND '75 REFLECTED A VARIETY OF SPECIAL INFLUENCES. SOME WERE DEMAND ORIENTED AND AFFECTED TO SOME EXTENT BY POLICY SUCH AS THE WORLD-WIDE ECONOMIC BOOM SUPERIMPOSED ON THE BOOM IN THE UNITED STATES, AND THE DEPRECIATION OF THE DOLLAR IN FOREIGN EXCHANGE MARKETS THAT BOOSTED PRICES OF IMPORTED GOODS AND ADDED TO THE DEMANDS ON OUR OWN PRODUCTIVE RESOURCES. BUT OTHER INFLUENCES WERE SUPPLY ORIENTED. WE ENCOUNTERED CRITICAL SHORTAGES OF BASIC MATERIALS SINCE THE EXPANSION IN INDUSTRIAL CAPACITY TO PRODUCE THESE MATERIALS HAD NOT TAKEN PLACE. CROP FAILURES IN MANY COUNTRIES RESTRICTED SUPPLIES RESULTING IN THE RAPID ESCALATION OF FARM PRODUCT PRICES AND SHORTAGES IN THE ENERGY FIELD CAUSED FUEL PRICES TO SPURT UPWARD. EVEN IN THE ABSENCE OF UNREALISTIC PUBLIC EXPECTATIONS, THESE SPECIAL FACTORS WOULD HAVE MADE THE FORMULATION AND IMPLEMENTATION OF ECONOMIC STABILIZATION POLICIES DIFFICULT.

WHILE DIFFICULT, THE PROBLEM IS NON-INSOLVABLE. A MARKET ECONOMY SUCH AS OURS CAN RESPOND TO SHIFTS IN THE PATTERNS OF RESOURCE SCARCITY.

THIS DOES NOT MEAN THAT A SHORT-RUN ADJUSTMENT PROBLEM MAY NOT OR DOES NOT EXIST. HOWEVER, EVEN IN THE SHORT RUN THE PRICE MECHANISM CAN AND DOES WORK. WITH LIMITED SUPPLIES, PRICE SIGNALS WILL ACTIVATE THE ADJUSTMENT MECHANISM.

BEING CONFIDENT THAT WE CAN ADJUST TO SUPPLY CONSTRAINTS DOESN'T ELIMINATE THE DIFFICULTIES FOR ECONOMIC POLICY OR THE EXPECTATIONS OF WHAT THESE POLICIES CAN DELIVER. FIRST, THE ADJUSTMENT TAKES TIME. IT IS NOT INSTANTANEOUS. THUS, WE CAN ARGUE THAT IN THE PRESENCE OF SHORTAGES OF SUPPLY, POLICIES DESIGNED TO EXPAND TOTAL OUTPUT AND PERHAPS INCREASE EMPLOYMENT THROUGH DEMAND MANAGEMENT MAY WORK MORE SLOWLY THAN THEY WOULD WITHOUT SUPPLY CONSTRAINTS. SECOND, THE PROCESS OF ADJUSTMENT SUPPLIES UPWARD WILL, IN A MARKET ECONOMY, REQUIRE INCREASES IN PRICES. IT IS THE PRICE MECHANISM THAT COMMUNICATES THE DEMANDS FOR INCREASED CAPACITY, RAW MATERIALS OR NEW TECHNOLOGIES.

THERE IS AN IMPLICATION IN THIS THAT ECONOMIC POLICIES IN THE COMING YEARS MIGHT PROFITABLY FOCUS ON STEPS TO IMPROVE THE ADAPTIVE MECHANISM--STEPS TO SMOOTH OUT OR SPEED UP THE SHORT-RUN ADJUSTMENT AND REDUCE THE PRICE PRESSURES NECESSARY TO ACTIVATE ADJUSTMENTS BY MAKING APPROPRIATE INSTITUTIONAL CHANGES. FURTHER, OLD POLICIES AND PROGRAMS SHOULD BE REVIEWED FOR INDICATIONS OF COSTLY SUPPLY RESTRICTIONS AND NEW PROGRAMS CONSIDERED FOR STIMULATING SUPPLY DIRECTLY. NOR SHOULD WE IGNORE OTHER NEW PROGRAMS DESIGNED FOR OTHER PURPOSES. THE COSTS IN TERMS OF THE EFFECTS ON SUPPLIES SHOULD BE EXPLICITLY CONSIDERED IN OUR COST-BENEFIT CALCULATIONS.

EVEN WITH IMPROVEMENTS IN THE SPEED OF ADJUSTMENT, IT WILL, I FEAR, BE DIFFICULT TO ACHIEVE BOTH OF OUR GOALS OF FULL EMPLOYMENT AND PRICE STABILITY SIMULTANEOUSLY. IN THE PRESENCE OF NON-HUMAN

RESOURCE SCARCITIES, WE MAY NOT ALWAYS BE ABLE TO ACHIEVE FULL EMPLOYMENT BEFORE GENERATING PRICE PRESSURES ON OUR OTHER RESOURCES. ADAPTATION MAY SIMPLY NOT BE THAT RAPID.

THIS PUTS HEAVY PRESSURE ON ECONOMIC POLICY FORMULATION AND IMPLEMENTATION. THE PROCESS OF ACHIEVING ONE OF THE GOALS, FOR EXAMPLE, UNEMPLOYMENT, CAN PUT US IN A FUTURE POSITION WHERE NOT ONLY IS THE OTHER GOAL (PRICE STABILITY) OUTSIDE ITS RANGE OF TOLERANCE BUT ALSO WHERE IT IS IMPOSSIBLE TO CONTINUE TO ACHIEVE THE FIRST GOAL. THE OBJECTIVE OF ECONOMIC POLICY CONTROLS CANNOT BE SIMPLY TO GET US FROM WHERE WE ARE TO WHERE WE WOULD LIKE TO BE. THE OPTIMAL POLICY IS ONE THAT BRINGS THE ECONOMY TO A DESIRED POINT IN THE "BEST WAY". THE ECONOMY IS DYNAMIC AND POLICIES SET IN MOTION A WHOLE TRAIN OF EVENTS THAT IF NOT CAREFULLY WATCHED CAN BRING US TO A STATE BEYOND THE TARGETED POINT THAT IS UNTENABLE.

ALL THIS MEANS SIMPLY, AS I'VE SAID BEFORE, THAT OUR POLICIES MUST BE CONCEIVED WITHIN A BROADER TIME FRAME THAN IN THE PAST. I AM CONCERNED, AS I INDICATED EARLIER, WITH THE TENDENCY FOR PUBLIC EXPECTATIONS TO OUTFRAN REALITIES IN THE ECONOMIC SPHERE. THIS IS TRUE NOT ONLY FROM THE STANDPOINT OF SHORTAGES BUT ALSO FROM THE STANDPOINT OF THE NEAR-TERM ATTAINABILITY OF OUR GOALS. THERE IS NO INSTANT CORRECTION TO OUR INFLATION PROBLEM NOR TO OUR UNEMPLOYMENT DIFFICULTIES. IT WILL TAKE TIME FOR OUR ECONOMY TO MAKE THE NECESSARY CORRECTION.

WE ARE MAKING GOOD PROGRESS NOW. WE HAVE WEATHERED THE SHARPEST DECLINE IN REAL ECONOMIC ACTIVITY, THE HIGHEST UNEMPLOYMENT, THE LARGEST FEDERAL DEFICIT AND THE HIGHEST RATE OF INFLATION IN THE POST-WORLD WAR II PERIOD. RECENT EVIDENCE IS BEGINNING TO PUT A MUCH MORE FAVORABLE CAST ON THE FUTURE. EMPLOYMENT HAS INCREASED 1 1/2 MILLION SINCE THE LOW INTEREST RATES HAVE FALLEN DRAMATICALLY. INDUSTRIAL PRODUCTION IS REGAINING LOST GROUND. RETAIL SALES HAVE SPURTED AHEAD AND SEEM TO BE SUSTAINING THEIR UPWARD PATH.

THE RECOVERY IS CLEARLY NOT ONLY UNDERWAY BUT SOLID. THE UPTREND WILL CONTINUE THROUGHOUT THE YEAR. PROGRESS WILL BE MADE IN GETTING THE UNEMPLOYMENT RATE DOWN AND THE RATE OF PRICE INCREASES SHOULD CONTINUE TO DECLINE.

WE HAVE ALREADY SEEN PRESSURES FOR A MORE STIMULATIVE ECONOMIC POLICY. BUT THE MORE MODERATE COURSE FOR BOTH FISCAL AND MONETARY POLICY WILL BETTER SERVE TO PROMOTE SUSTAINABLE ECONOMIC GROWTH AND AT THE SAME TIME BANK THE FIRES OF INFLATION.

I REALIZE THAT THIS KIND OF POLICY DOES NOT REDUCE THE INFLATION RATE AS FAST AS WE ALL WOULD PREFER. BUT WITH UNEMPLOYMENT INSURANCE, FOOD STAMPS, MEDICAID, AND OTHER TYPES OF INCOME MAINTENANCE PROGRAMS, THE MISERY SUFFERED BY THE UNEMPLOYED HAS BEEN REDUCED. AND WE ARE ALL ALSO BEGINNING TO REALIZE THAT INFLATION IS VERY COSTLY. POLICIES LEADING TO INFLATIONARY PRESSURES RESULT IN THE LONG RUN TO THE DESTRUCTION OF JOBS, NOT IN THEIR CREATION. THE VERY GROUPS WHICH ARE TO BE HELPED ARE HURT THE MOST. THE OPERATION OF OUR TREMENDOUSLY