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FREE MARKETS: A FOUNDATION FOR PROSPERITY

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This is a time of very exciting and positive change. Throughout the world, countries are turning toward market economies to achieve higher standards of living. In the United States, we have made many changes over the last decade to free-up market forces, although additional regulatory burdens have been imposed. On balance, however, I believe that the 1990s could be a decade of unprecedented prosperity for this country and the world if certain pitfalls are avoided.

My optimism about the future is based on the movement world wide toward greater use of free markets. Such markets have the capacity to direct the efficient use of resources and to produce higher standards of living. The market system tends naturally toward full use of resources, and toward saving, investment, and growth. To work at its best, however, the market system must operate in a legal and institutional setting where property rights are protected, where government's interferences with the economy and with private decisions are minimized, and where the purchasing power of currency is stable. Consequently, we must govern ourselves in ways that avoid pitfalls such as abrogation of property rights, stop-go macroeconomic policy changes, intrusion into private economic decisions, unnecessary regulation of commerce, and inflation.

You, as influential people in your organizations and communities, have key roles to play in restoring and protecting a political, legal, and economic environment that can facilitate market mechanisms and increase our nation's prosperity.

Market Forces versus Government Control: The Great Test

During the last six or seven decades, we witnessed a great test comparing the efficacy of free market economies with that of governmental planning and control. The 1930s was a watershed decade throughout the world. In the wake of a world wide depression, the knee jerk response of many countries was to adopt corporate statism as a way of organizing political and economic life. The role of market forces in directing economic activity was diminished as governments became regarded as a partner or a boss. Governments throughout the world greatly increased their intrusion into such decisions as what one could produce, where one could produce it, how much one could charge for it, how much one could pay labor, what interest rates one could pay, what interest rates one could charge, and how much of one's earnings one could keep.

Although these intrusions were world wide, they were most extreme in the communist nations. The great experiment with central ownership began following the Russian revolution and, after World War II, the experiment expanded to Eastern European nations, China, and others.

For a while, command systems appeared capable of directing resources toward highly-valued political objectives. Military machines of great power were developed. At the same time, propaganda machines persuaded many of us that substantial gains in public health and living standards were also being achieved. But in the 1970s and 1980s, it became apparent that command systems were unable to deliver acceptable standards of living. And, now as the vast degradation of environment, infrastructure, and public health has been exposed in eastern Europe and the former Soviet Union, it is known that the shortcomings of central planning were even greater than most had imagined.

While centrally planned economies were moving toward their inevitable collapse, market economies were sprinting ahead. The mixed market economies of the United States, Canada, and western Europe have long demonstrated the ability of market systems and personal freedom to generate ever greater increases in prosperity. More recently, and much more dramatically, the economies of Japan, South Korea, Taiwan, Hong Kong, and Singapore -- the so-called Asian tigers -- and some others have reinforced this point.

Indeed, the 1980s appear to have been another watershed decade, a time when previous beliefs about the appropriate role of government in the economy were questioned. People across the world recognized that productivity increased most rapidly in countries where markets, not governments, directed resource allocation. This is evident not only in comparisons between the centrally planned countries and the western industrialized nations, but also in comparisons among Third World countries with varying degrees of freedom from government intrusion into the economic decisions of citizens.

Almost everywhere, governments are increasingly seen as part of the problem, not the solution. On every continent, there are examples of denationalization (privatization) and deregulation. It is hard to name a single country where government is aggressively nationalizing an otherwise private industry. Governments are either privatizing, deregulating, or doing nothing. Controls on credit, interest rates, wages, prices, exchange rates, and capital flows are being removed.

Some Comments on Market Economies

Even though the market system has proved superior by the test of the last six decades, we should not pat ourselves on the back, say "Adam Smith was right," and rest on our oars.

To perform at its best, a market economy needs a stable business and political environment and substantial property rights. It needs to operate in the context of a legal system that defines the rights of citizens and the powers of government. We, the people, must govern ourselves in a way that provides a stable and positive business environment, that protects property and personal rights, and that limits the powers of government.

Market economies are superior to alternative arrangements because they allocate resources efficiently. They do so by capitalizing on the decisions, creativity, and energy brought forth by humans' natural self-interest. To energize that self-interest, individuals must be able to benefit substantially and directly from the income and property that they produce. Consequently, the right to keep and use property -- whether physical, financial, or intellectual -- is a key ingredient of a market economy. A tragedy of the past several decades has been the willingness of individuals to cede their natural law property rights to governments. For example, through their governments, people have imposed on themselves high tax rates, inflation, and excessive regulation.

Market economies are inherently resilient. That is, the price system moves economies toward full employment of available resources. A market economy might be knocked away from full employment by some external or government-imposed shock, but it will naturally revert toward full use of resources. This happens because it is in the self-interest of resource owners, including workers, to fully employ resources rather than allow them to be idle and unproductive.

Governments have often used changes in fiscal and monetary policy to try to push an economy to fuller employment of resources. Such attempts at "countercyclical" policy can easily backfire. For example, attempts to push down nominal interest rates through faster money supply growth can lead to expectations of higher inflation and, consequently, to higher long-term interest rates.

Changes in government policies can also be destabilizing by creating uncertainty about future policies, and making planning more difficult. Business managers then focus their attention on trying to anticipate future actions of government, instead of focusing on increasing the efficiency of their own firms. In that environment, a decision maker will be reluctant to initiate a project that might take two or three years to bring on stream, because it might be brought into production at just the wrong time. Fortunately, countercyclical monetary and fiscal policies have been substantially discredited over the last decade.

In a stable business and political environment, market economies are naturally driven toward growth. Such growth does not require government initiatives, incentives, or instructions. Rather, growth occurs in response to people's creation of additional knowledge and property. Misguided government actions that cause uncertainty or instability can, however, slow, stop, or even reverse that process.

Individuals save out of current income and invest in acquiring knowledge or property so that they can have more income and consumption in the future. However, their willingness to save and invest is dependent on a few necessary conditions. First, they must have the expectation that they, or their children, will be able to benefit from the extra income that they generate. That is, their property rights must be secure. Second, economic conditions must be sufficiently stable so that they can form sound expectations about the future. That is, they need a suitably long planning horizon.

Unfortunately, we the people, through our government, inflict on ourselves changes that shorten our planning horizon. We continually change regulations about the use of property. We continually change tax laws. We continually change government spending programs. And, we adopt monetary policies that result in inflation.

Inflation saps the strength of a market economy by abrogating property rights and by shortening the planning horizon. Inflation is nothing more than a debasement of the currency, a reduction of its purchasing power. Thus, inflation takes property without legislation or due process. Moreover, inflation distorts relative prices, reducing the efficiency of the resource allocation process. This, and its unpredictability, shorten the planning horizon.

Cold War Victors Are Not Home Free

Although major western countries have been victorious in the economic and cold war competitions with the former Eastern Bloc countries, there are several economic problems to be resolved. It is somewhat ironic that, having won in those competitions, domestic problems are hampering the ability of western industrial nations to provide world leadership.

Let me offer some examples. The reunification of East and West Germany is being pursued with a redistribution of resources from West Germans to East Germans. Instead of taxing resources of the West Germans to transfer to the East Germans, the redistribution is being financed with debt. In addition, the Bundesbank is monetizing some of that debt, leaving German inflation uncharacteristically and unacceptably high.

In the United States, our national fiscal problems are well known. As a people, we seem to have an insatiable appetite for government services and transfer payments, but little appetite for taxing ourselves to pay for them.

A third example is the European Community, which is committed to the establishment of a new European central bank before the end of this decade. Some observers have noted that there is a risk that the bank will be fashioned in a manner that enables the Community to use inflation in an attempt to avoid fiscal discipline.

What these three examples have in common are that fiscal difficulties can put enormous pressures on monetary authorities to inflate, either to raise revenue or to reduce the burden of debt service. And inflation, we know, hampers the efficiency of market systems and shortens investors' planning horizons by increasing uncertainty, thereby reducing prosperity.

There are other examples. The European Community is committed to establishing a new set of governance institutions. Whether the world in general, or even Europe, in particular, will benefit from these institutions depends on what happens to the property rights of Europeans and the ability and scope for markets to work. We can only hope that the Community will eliminate many of the economic restrictions now embodied in their national borders, and will harmonize and reduce economic regulations. Unfortunately, it is also possible that a Community-wide government might instead become an added layer of interferences with private property and markets.

As you know, we in North America are also negotiating reductions in the interference with free market forces that the United States and other sovereign nations unfortunately tend to impose at their geographic boundaries. The Canadian-U.S. Free Trade Agreement is being phased in: a North American Free Trade Agreement is being negotiated with the U.S., Mexico, and Canada; and preliminary discussions about free trade have been initiated between the U.S. and various other nations in this hemisphere. Agreements that will open borders for goods, services, and investment should be sought because this will widen the scope of markets and enhance prosperity here and abroad.

The economic prosperity of the United States can also be augmented by enhancing the ability of the dollar to perform its three unique roles in the world economy. The dollar is used world wide as a vehicle currency, a reserve currency, and as a store of value. The dollar is the world's pre-eminent vehicle currency in the sense that it is readily accepted in payment for exports, even when neither the importer nor the exporter is American. The dollar is also the world's preeminent reserve currency, used by most governments as a store of international wealth. And, the U.S. greenback is often the currency of choice for use as a store of wealth by individuals in nations suffering from high rates of inflation or political instability.

The dollar's use in these ways is beneficial to us whether we are traders, travelers, or investors. We can increase the degree to which the dollar is used for these purposes by achieving price stability and by demonstrating our capacity and determination to maintain price stability.

Let me give one last example of how market forces are important. A frequently expressed concern is whether the United States can compete in world markets. I believe that one of the key requirements for being competitive and, more fundamentally, for increasing our standard of living, is to have a well-educated work force.

There is no question that the United States has the finest system of higher education in the world. The thousands of students from all over the world who flock to our college and university campuses are proof of this. But we cannot be as pleased when discussing our primary and high school system. There is ample evidence that, compared to other industrialized nations, our system yields results that are far from the best.

Clearly, our colleges and universities compete for students much more than do our primary and secondary schools. When looked at from the other side, our consumers of higher education have much more choice than do our consumers of primary and high school education. I believe that it is no coincidence that quality is greater where competition is greater. All of our knowledge of how markets work leads us to expect such an outcome. If we introduce more market forces into our primary and secondary education system, we would enhance the quality of the education that is delivered.

Domestic Economic Problems and World Leadership

The world wide move toward greater use of market systems holds the promise for a more prosperous future. Fluctuations in the business environment should be much smaller as governments reduce their intrusions into decisions about the use of private property, reduce their use of stop-go policies that were misnamed "countercyclical" policies, and reduce rates of inflation. In a more stable business environment, planning horizons will be lengthened and will facilitate a shift of resources from current consumption into investment for greater real output and consumption in the future.

The United States will either enhance its stature as leader in that more prosperous world, or see that stature eroded, depending on the degree to which we solve our domestic problems. Solving domestic economic problems will not only improve our image, but also will directly increase our capacity to contribute to the solution of international problems.

Let me identify three examples of how domestic problems currently reduce our ability to be a positive influence in the world. First, an inadequate education system hampers our competitiveness and thereby our willingness to be a more vigorous proponent of free trade.

Second, inflation reduces the efficiency of the economy and hampers planning for investment, thereby reducing present and future incomes. It is income, of course, that is the key resource for many of the goals that we might want to accomplish here and abroad.

Third, inflation reduces the international usefulness of the dollar as a vehicle currency for trade and as a store of value. Loss of acceptability of the dollar for these purposes, which is inevitable in an inflationary regime, reduces world prosperity by making international trade in goods and services more difficult to transact and by narrowing the opportunities for people in some nations to protect themselves from inflationary or oppressive regimes.

In my view, all of these problems involve interference with natural market mechanisms.

Conclusion: The Challenges Facing Us As Leaders

As a society we should pursue price stability directly. But, more broadly, we need to understand more fully and accept the value of personal liberty and markets, the market's natural resiliency, and its ability to generate maximum real growth. All of us need to work to protect and nurture our market system.

We are all in this together. The outcome does not depend on what "the government" does. The outcome depends on what we, you and I, in our roles as leaders of our organizations and communities, and as voters and lobbyists, do to protect, nurture, and expand the market system. We must expose as untrue the belief that government can create prosperity, and instead promote the view that the first rule for governments should be the same as that set forth by Hippocrates for physicians: "Do no harm." We must be active in protecting property rights, championing freedom from regulation, pursuing fiscal stability, and seeking price stability. These are key ingredients for the perpetuation and enhancement of the market system that can serve us, and the world, so well.