

Speeches by Bob McTeer

Individual Freedom and the New Economy

Remarks before the Cato City Seminar, "Liberty in the New Millennium"

Houston, Texas

Sept. 20, 2000

When I saw the topic I'd been assigned, "Individual Freedom and the New Economy," I called Ed and told him it was too philosophical for me, too deep. I have a lot of shallow thoughts, which I hope will add up to at least one deep thought some day. But I don't have deep thoughts all at once.

Confidentially, I get most of my deep thoughts from Jack Handey, on *Saturday Night Live*. Here is my favorite: "The other day I got out my can opener and was opening a can of worms when I thought, 'What am I doing?'"

It's probably a good thing Ed suggested a new wrinkle for me. I've made so many talks on the New Economy lately that I hardly know what's left to say. I know it's supposed to be easier to change audiences than to write a new speech, but that was before the days of Fed watchers and reporters who follow you around taking notes on everything you say. Some even put their live cell phones on the lectern and cut out the middleman. You can run from them, but you can't hide. They know what you said and when and where better than you do.

I feel a bit like Jack Kennedy when he told his aide what he planned to say in his next speech. The aide told him he couldn't say that. Why not? Kennedy asked. Because it contradicts what you said last week in Philadelphia, he was told. Kennedy said, "I'll deny I was ever in Philadelphia."

I wasn't in Philadelphia last week, but I was in Chicago, talking to the National Association of Business Economists. I just returned last night from Washington, where I talked to the American Bankers Association. My Chicago speech to the economists is mentioned, among other places, in the current issue of *Business Week* [September 25]. The article is mostly about the forecast survey of those economists. But the article says, "Even Dallas Reserve Bank President Robert McTeer, easily the Fed's most vocal New Economy advocate, was on hand to deliver a rousing sermon." "Sermon," it says.

In summarizing the NABE forecasts, *Business Week* reports that they expect real growth to be 4.1 percent in 2000 and a still-healthy 3.3 percent in 2001. They expect the unemployment rate to edge up—hardly at all—from only 4 percent this year to 4.2 percent in 2001. They believe the economy's higher noninflationary speed limit, made possible by rapid productivity growth, will allow inflation to fall to 2.6 percent next year, from 3.3 percent this year.

The article goes on to say that the concept of NAIRU, the non-accelerating inflation rate of unemployment, took a beating among the economists. (The idea is that below a certain unemployment rate—the NAIRU—inflation is bound to rise.) In response to a question included in the survey on my behalf, 40 percent said NAIRU is of only limited use and 17 percent called it useless.

The article concludes that the economists have faith in the Fed and in the Fed's willingness to give policy "a New Economy slant." It says that's much more optimistic than they were last year, when they expected 2000 growth at an uninspiring 2.6 percent. The last sentence of the article says, and I quote, "As Brother McTeer might say, amen to that."

Well, there you have it. The New Economy rules. The good guys have won.

But what's all this about "Brother McTeer" and my delivering "a rousing sermon"? I must have been waxing evangelical without knowing it. (It is true that years ago, my mother wanted me to become a preacher. She said I could make a lot of money that way. I told her that might be true, but what would I spend it on?)

While the battle has apparently already been won, let me just summarize what I mean by the New Economy.

Some people delight in pointing out there's nothing really new about the New Economy. We had one like it before, about a hundred years ago. Okay. To market it better, we probably should have called it the "New and Improved Economy," like "new and improved Tide." A sexier title might be "Revenge of the Nerds," which is really what it

amounts to. All those guys you remember from high school who didn't play football and had skinny arms and stayed indoors studying all the time are now running the New Economy.

The current economic expansion, as you know, is the longest on record, beginning in April 1991. It's now in its tenth year. But the New and Improved Economy didn't really kick in until the mid-'90s, toward the end of 1995. That's when the economy got its mojo working, when Stella got her groove back and when Rosie's scenario finally came true.

Let me just list some of its features:

Productivity growth doubled from the 1 to 1.5 percent range of the past two decades to at least 3 percent growth. It grew more than 5 percent over the past year and actually reduced unit labor costs.

That caused output growth to almost double, from its maximum "speed limit" of 2 to 2.5 percent for two decades to over 4 percent for the past four and a half years. For the past four quarters, GDP growth was 6 percent.

The unemployment rate, whose lowest noninflationary level—the NAIRU—had been considered to be as high as 6 percent, came down to 4 percent, where it's been for a while without serious inflationary consequences.

Wage growth accelerated, but accelerating growth in labor productivity—we call it labor productivity, but it results from giving labor more capital to work with—kept unit labor costs contained despite rising wages and fringe benefits.

High-tech investment opportunities raised corporate profit prospects substantially and created a prolonged investment boom that added to the capital-labor ratio and raised productivity in a virtuous circle.

I don't believe in the Phillips curve, which says if unemployment goes down inflation goes up and vice versa. But if there is one, it's been a funny-looking curve these past few years, since unemployment and inflation, until recently, declined together. That's an upward-sloping Phillips curve.

The recent inflation creep results primarily from higher oil and gas prices, which I won't comment on until I get out of Houston. I don't believe in the kissing cousin of the Phillips curve—the NAIRU. But if it exists, it's been sinking like a stone. What good is a NAIRU if it won't hold still?

The new and improved economy has its own rewards, but some collateral benefits include successful welfare reform; the strong New Economy's turning of federal budget deficits into surpluses; and the good things that go along with fuller employment and higher incomes, like reduced crime and better health.

What caused the improvement in the economy? I'd give some credit to a noninflationary monetary policy, which creates a favorable environment for growth. But most of the credit goes to technology. And free enterprise. And animal spirits. And entrepreneurs.

The list continues: high tech, both biotech and electronic high tech. Of the two, I think biotech will be the bigger deal in the next decade and century. And Houston seems to be emerging as the most likely biotech center in Texas.

But let's leave biotech for another day and focus on electronic high tech. Actually, it's mostly information and communications technology. If they were naming the computer today, they would probably call it a "communicator" rather than a "computer."

Progress in technology has been going on for a long time. But for some reason it didn't have much measurable impact on productivity until the mid-1990s. I'm not sure why it seemed to reach some sort of critical mass then. Many things—like software—came of age, came together, created technology spillovers and synergies. What I call "invention on demand" speeded up. We no longer wait for an unknown inventor working in his garage to invent the new thing. We decide what we need and assign the job. Certainly the spread of the Internet to the broad population was important, with the creation of the World Wide Web and browsers. Computer chips became more customized and ubiquitous; little brains are being put in everything.

Mike Cox has a good discussion of some of the technology in our annual report essay on the New Paradigm. I recommend it highly.

Why did the stronger growth, boosted by technology, generate less inflation than usual? First, high-tech production is inherently deflationary. Moore's law. Declining PC prices. Declining prices for all things electronic. Second, the use of high-tech products as labor-saving measures throughout the economy is also inherently disinflationary.

The economics of the New Economy are somewhat different. Typically, fixed costs are very high and marginal costs are very low. The first copy of new software may cost millions; then it becomes almost free to reproduce.

So the bigger the market, the better, the cheaper. The first new medicine is similar to software: high up-front costs, then very low marginal cost. Low marginal costs means prices decline with volume. Size matters, and in our new competitive global economy, the world is the marketplace.

The Old Economy has decreasing returns to scale, after a point. The New Economy has more increasing returns, declining long-run costs, greater ease of entry for web-based businesses. In the new and improved economy, the value of networks rises for everyone when new people are added.

In a knowledge economy or information economy, you don't destroy the product when you consume it. Knowledge and information accumulate and compound. Knowledge compounds like compound interest.

Adding to the forces that reduce the potential inflationary impact of more rapid growth are the various aspects of globalization or, more precisely, the competitive global economy.

Here is an incomplete list:

- The end of the 50-year Cold War. (As Ed Yardeni says, wars are inflationary, peace is not.)
- The collapse of communism and hard-core socialism.
- Privatization and deregulation, all over the world.

Capitalism is not only replacing communism and socialism, but even capitalism is becoming purer, more like the textbook model of pure competition. The Asian crisis showed the disadvantages of the Japanese model of state-guided capitalism, which had become the Asian model. We learned a new term: *crony capitalism*. "Euroclerosis" over recent years has shown the disadvantages of many European versions of capitalism—the "nanny state." Europeans say they don't want raw capitalism or unadulterated capitalism. They must want "adulterated" capitalism.

To paraphrase Ed Yardeni, who says it best: Small, regulated, monopolized, protected and corrupt markets are inflationary. Globalized, privatized, deregulated and competitive markets are not.

Enough fighting a battle that may be already won. What about personal freedom and the New Economy?

One of the first economics books I read and liked was Milton Friedman's *Capitalism and Freedom*, from the early '60s. A later, similar book of his was *Free to Choose*. As Friedman points out, capitalism and freedom go together. As so many millions of people have moved away from communism and socialism into market economies, freedom in the world is greatly enhanced.

We are individually free to do more things when our incomes are higher and our higher incomes afford us more choices. The New Economy has increased productivity growth—which is a pretty good proxy for standard of living—by at least a factor of 2, probably more. That means our standard of living will double in half the time it would have under the old growth rates.

The New Economy features information technology. That, especially, helps us learn and communicate—essential ingredients of freedom. Especially the Internet. CNN has shed light on abusive government practices in remote corners of the world. First CNN, now the Internet.

Governments no longer have a monopoly on information. Like central bankers, they can run but they can't hide. Wireless and other new technologies will let poor countries leapfrog older technologies and shortcut the path to prosperity, giving billions of people more freedom from hunger and poverty and the darkness of isolation.

These aren't deep thoughts. They aren't even very wide or very new. But it seems almost self-evident that the New Economy is expanding individual freedom in many ways. While I was off fighting the New Economy wars in Chicago and Washington these past few days, I asked an assistant to compile a list of new freedoms in the New Economy. You may not agree with all of them. But the list makes you think.

The freedom:

1. To work anywhere, not just at the "office." Telecommute.
2. To work odd hours. Have a flexible work schedule.
3. To dress casually.
4. To communicate from anywhere. Cell phones.
5. To shop without leaving home. Internet.
6. From waiting/standing in line. Shop online, not in line.
7. Of access to so much more information. No longer bound by the Encyclopaedia Britannica for our facts, we have numerous search engines that canvas everything instantly.
8. Of speech. Park your ideas on a web site or blather your head off in a chat room.
9. From acts of randomness, such as accidents. Computer-operated antilock brakes reduce auto accidents. New software in development allows computers to take control of planes that have lost a major part of their wing or tail and land them safely. The "life" in "Well, that's life" isn't the same anymore.
10. From our own genetic code. The Human Genome Project promises to deliver us from the bondage of our own genetic code, switch off the gene for diabetes and so on.
11. From nature, from the world of "natural resources." Nanotech promises whole new materials with exactly the properties we desire, not just those that occur in nature.
12. From snail mail (the post office). Fax, e-mail.
13. From communism. The Iron Curtain was destroyed by new technology that made it impossible for the Soviet propaganda machine to maintain the veil of ignorance.
14. Of choice. Mass customization, made-to-order quality at mass production prices.
15. From menial tasks. Microwave.
16. From pollution. Noise reduction technology is on the way. DigiScents' new nose chip constantly samples the air, allowing us to zap pollutants with various new technologies.
17. To learn in nontraditional ways.
18. From discrimination. The Internet is color-blind. You can't tell the age, race or gender of the worker at the other end of the line.
19. From so much taxation. So far.
20. From the heavy burden of government regulation. Renew driver's licenses online, etc.
21. From yesterday's growth limits. Relaxation of the law of decreasing returns to scale that plagues Old Economy industries. More New (information, network) Economy industries for which the laws of increasing returns to scale better apply.
22. To stay in your home country yet work in another, and at a better salary. It's easier to outsource New Economy work to foreign countries than Old Economy work.
23. To job hunt more easily and thoroughly, without even taking off work. Jobs.com.
24. To fail ... or succeed marvelously. The churn is busily at work making the world of tomorrow as different from that of today as the world after electricity was different from that before it.