Speeches by Bob McTeer

Problems Making the Case for the Market: Good Intentions or Good Results
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Ever since I was invited to speak here tonight, I've been wondering what a backsliding Southern Baptist from the foothills of North Georgia has to say to an Acton Institute audience.

Father Sirico gave the speech I should give over eight years ago at the Dallas Fed. His topic was "Examining the Moral Dimensions of Monetary Policy." He pointed out that not only is inflation bad in the economic sense but that permitting inflation to erode the value of our money is essentially immoral.

Too many good people—because they are good people, they think—believe that a moral monetary policy is necessarily an easy money policy. They call for more money and more credit and mistakenly believe that the Treasury's printing press is the key to earthly salvation. They are subject to what I'll discuss later as the fallacy of composition. In making his case for the immorality of inflation, Father Sirico cited chapter and verse–literally.

Henry Wallich, a former Fed governor, also discussed the immorality of inflation in a 1978 commencement address. He titled his speech "Honest Money," and cited the "breakdown in our standards of measuring economic values as a consequence of inflation." He pointed out that "inflation introduces an element of deceit into most of our economic dealings. Everybody makes contracts knowing perfectly well that they will not be kept in terms of constant values," a "condition that is hard to reconcile with simple honesty."

He said inflation is a means by which the strong exploit the weak. He might have added that inflation also hurts the poor more than the rich and minorities more than the majority.

I combined Henry Wallich's commencement address and Father Sirico's remarks at the Dallas Fed, added my own introduction, and inaugurated a new Dallas Fed publication called *Economic Insights*, which you may find, among other good things, on our web site, www.dallasfed.org. Father Sirico helped start something in vol. 1 no. 1 of *Economic Insights* that he probably didn't know about. As Martha Stewart might have said in happier times, "It's a good thing."

I'm happy to report to you tonight that the evils of inflation are greatly diminished, as we've made considerable progress reducing inflation in recent years. Inflation is low and is poised to go lower, given the slack in the economy, the sluggish recovery and continued productivity growth.

Have we finally achieved price stability? Not quite, but we're getting close. So close in fact that some people worry that our disinflation could turn into deflation. As Scarlett O'Hara used to say, I'll worry about that tomorrow.

Before I started thinking about tonight's remarks, I would have denied thinking about economic issues in a moral context. But since I've always felt free to offer my views on good vs. bad economic policies, I must have had some implicit moral or ethical basis for making those distinctions. Since a Pareto optimum is probably unattainable, the policies I favor necessarily make some people worse off. But they make more people better off, and if the voters decided to make the losers whole, they could tax the gainers, to compensate the losers, and still have economic benefits left over.

That option is usually made explicit by advocates of free trade, which I am. The benefits of free trade are widespread and substantial compared with the losses that some people suffer. Theoretically, you could apply the same test to the benefits of not having a minimum wage law or not raising the minimum. Of not having farm price supports or rent controls, and so on.

Most "good" economic policies help many people a little and hurt a few people a lot. That makes good economic policy difficult politically since those harmed know who they are and know their congressman's telephone number. The gainers each gain only a little and often aren't even aware of it. Diffused benefits and concentrated costs are a difficult problem to overcome in trying to make the case for market oriented-policies.

I suspect I'm on fairly safe moral ground advocating market-friendly policies, since the efficiency of markets generally results in a larger economic pie to be divided. Most efforts to distribute the pie differently result in a smaller pie to be divided. There's nothing moral to me about killing the goose that lays the golden eggs.

The daily newspapers these days are full of moral dilemmas that, to me, don't have easy answers. For example, we have long made a distinction between *avoiding* taxes legally and *evading* taxes illegally. Is that legal distinction also a moral distinction? I suppose so, as long as you don't stay legal by telling less than the truth, the whole truth and nothing but the truth.

What about aggressively pushing the envelope in interpreting and applying generally accepted accounting principles your business? If you push the envelope too hard, do you go to hell as well as jail?

What about issuing an annual report that doesn't contain actual falsehoods but doesn't explicitly call attention to all the firm's debt? What if legal as well as generally acceptable accounting treatments lead to outcomes that seem perverse from a commonsense point of view? Does getting agreement from your auditors help? What about your lawyers? Does that help or hurt? How does "Thou shalt follow GAAP accounting" sound as an 11th commandment? Maybe we could substitute it for one of the original 10. I've always thought we had one too many anyway. Just kidding, Father.

I don't mean to trivialize these contemporary ethical issues, but I don't have much serious to offer. I suppose you should treat such questions like you treat the question "Am I an alcoholic?" Generally, if you have to ask the question, you know the answer.

My guess is that most of the corporate shenanigans started out innocently enough. The move from long-term profit maximization to short-term stock price maximization—with the rewards to the decisionmakers tied to the stock price—started some good people down a slippery slope when the first step was pretty minor. First you do something only a little out of the ordinary to make this quarter's numbers. That makes next quarter's numbers more difficult, calling for more extraordinary actions. Pretty soon you are in over your head, hoping that the boom or inflation or the bull market will bail you out. If those gods cooperate with you, your reputation as a genius grows, and pretty soon you start believing your own press.

These recent episodes surprised me. I'm naive. And I remain naive, I guess. In no way do I believe they are endemic to capitalism. No matter how much shows up as the pond is drained, I remain convinced that the transparency of a market system is less a breeding ground for wrongdoing than a more closed, secretive, command and control system, where power is wielded by men rather than markets.

Milton Friedman, in *Capitalism and Freedom*, argued that racial discrimination is less likely in a capitalist system because of the anonymity of its participants. Each product we buy has perhaps hundreds of people involved in some way in its production and distribution. We don't know who they are or what color they are. Under communism, socialism or even a highly regulated mixed economy, people have more monopoly power with which to exploit others than under a competitive market system. I think the same reasoning applies to other types of moral and ethical misbehavior.

The recent revelations have triggered a move toward remedial legislation and regulation. I fear overkill. Laws that try to cover every type of circumstance in advance are bound to have undesirable, unintended consequences and move us back in the wrong direction. That is the message of Philip Howard's excellent book, *The Death of Common Sense*.

It seems that the moral high ground is reserved for those with good intentions, even if good intentions don't produce better results. That's quite an advantage in public policy debates. They get credit for having a good heart while their opponents are seen as hardheaded. Hardheaded becomes hard-hearted.

In *The Vision of the Anointed*, Thomas Sowell points out that when Hayek's *Road to Serfdom* attacked the welfare state and socialism in 1944, he characterized his adversaries as "single-minded idealists" and "authors whose sincerity and disinterestedness are above suspicion." But his own book was treated as something immoral, and some

American publishers refused to publish it, despite its already demonstrated impact in England.

How many times have you heard a minimum-wage debate on radio or TV? The hardhead will argue that yes, some people will earn more if the minimum wage is raised, but much employment, especially low-skilled employment, that would have taken place at the lower minimum won't take place at the higher minimum. The soft heart answers with a non sequitur like, "Yes, but a family can't live decently on the old minimum wage." The interesting thing is how often that argument wins. A triumph of good intentions over good results.

A couple of years ago, I testified for free trade before a panel of presidential appointees charged with holding hearings around the country on the trade deficit. A businessman followed me. He also supported free trade, but it was clear that he did so because he believed his company would benefit from more exports. A true free trader would be for free trade because of imports. Imports are the benefits of trade; exports are the cost of trade.

Almost everyone gets that backwards. I know of one notable exception, our Dallas congresswoman, Eddie Bernice Johnson, who understands and is willing to articulate the point that poor people benefit greatly from imports. They especially benefit from the low prices you can get in Wal-Mart and Kmart for goods made in China. Hooray for her. She gets it.

Others may get it too but pretend not to and vote differently because they'd rather pander to their constituents than try to educate them. The public needs to learn what the Acton Institute and others teach:

> the incentive role of profits and private property,
> the directing and coordinating role of market prices,
> the discipline of competition,
> the rejuvenating role of creative destruction,
> the reconciling role of Adam Smith's invisible hand
> and the potential damage that can be done by interfering with the above.

And from the Acton Institute, especially, we all need reassurance that there is nothing inherently or innately immoral about the market or those who participate in it.

Besides widespread ignorance about how markets operate, another obstacle in making the case for the market is that market solutions to economic problems sound to the uninitiated too much like a do-nothing approach.

And "do nothing" sounds too much like "don't care."

Red-blooded Americans crave action.

"Don't just stand there," they say. "Do something."

A good economist might say, "Don't do something; just stand there."

The 19th century economist Jeremy Bentham had it about right when he said, "In political economy, there is much to learn and little to do."

Another obstacle to effective economic education, in my opinion, is the way the public views economists. First, they regard them primarily as economic forecasters, and forecasting is a losing game. Nobody can do it well consistently.

Another obstacle is that while economists agree on many, many important things, they tend not to talk publicly about their agreement. Instead, they focus on minor points of disagreement. If professional economists can't agree, or if the range of expert opinion seems as wide among economists as it is among the public, then people conclude they might as well be their own economists. Their guess is as good as any, the rationale goes. So people become their own economists–especially bartenders, hairdressers and taxicab drivers. They can guess as good as anybody whether the Dow is likely to rise or fall next week.

Becoming your own economist usually means projecting the present into the future and generalizing from personal experience, which leads immediately to our old friend, the fallacy of composition. One person can see better by standing up at the football game, but if everyone stands up, it doesn't help. The Aggies at Texas A&M University haven't figured that out yet. They stand the entire game.

I mentioned the fallacy of competition earlier as it pertains to money and wealth. Money is wealth to its individual owner but not to society at large. If it were, then we could cure poverty with the printing press.

The money fallacy is also present when people talk these days about how much wealth was lost in the recent stock market correction–in the trillions of dollars. That may be an accurate sum of the net reductions in the accounts of stock owners. But the economy didn't lose trillions of dollars of real wealth.

The economy, the day after a stock market plunge, has the same number of buildings and factories and machines that it had the day before. Its ability to produce real goods and services has not been diminished.

Our money and other financial assets represent potential claims on future production. But future production hasn't been produced yet. Future production may or may not be affected by today's market decline. It probably will be if the correction causes a recession or reduces investment and, therefore, productivity over time. If the real economy is not impacted, real wealth in the aggregate may not be affected.

When stock prices rise rapidly, whether it's called a bubble or not, it's as though people are acquiring tickets to a football game to be played some time in the future, say, 20 years from now. The fans can all be accommodated only if the number of seats in the stadium increases as rapidly as the tickets sold. If the number of tickets grow faster than seats are added, the apparent wealth of the ticket owners is not all real. Having some of the tickets cancelled through a stock market correction may or may not affect the capacity of the stadium on game day, even though it will likely affect who gets to attend. It affects the distribution of wealth.

Similar considerations apply to the Social Security problem. We can tinker around with the financing, with who gets how many claims and who pays for them. But the fact remains that the value of our Social Security claims at retirement will depend on productivity growth between now and then and thus the economy's productive capacity at that future time. Wealth must be produced; it can't be printed.

Closely related to the fallacy of composition is what I call the "fallacy of job counting." Creating jobs is a favorite pastime of mayors, governors and chambers of commerce. They believe they are doing the Lord's work, and sometimes they may be. Individual towns may benefit by attracting new plants and new jobs. Or by subsidizing the construction of a new stadium. Or by subsidizing an unprofitable company to keep it from failing or relocating to Mexico. (By the way, Mexico is now losing jobs to China.)

Those new jobs are real to the local community and may give it a boost, but most of those jobs aren't new to the larger community. Most newly created jobs are filled by workers leaving other jobs. One community's job gains are usually another's job losses. Attracting jobs through subsidies often make the larger community poorer by allocating scarce resources to other than their most productive use. If you add up all the jobs local newspapers say have been "created," you will likely get more jobs than there are people to fill them.

From a very local perspective, all jobs are real and valuable. From the larger macro perspective, it's not potential jobs that are scarce, it's the people to fill jobs. What we ought to be doing is not counting jobs but making jobs count. We should make sure that scarce workers aren't wasted by putting them into suboptimal jobs. Who should decide what the right jobs are? And where? Let the market decide.

"Saving" jobs probably does more harm than trying to "create" jobs. What if the government, or a really strong union, had protected the jobs of telephone operators from modern, labor-saving technology? Given the explosive growth in telephone traffic in recent years, half our population would now be telephone operators. The rest of us would probably be elevator operators.

I once stayed in a hotel in Tokyo where a nice-looking woman stood in the lobby to greet you when you got off the elevator. Japan had a very low unemployment rate. But I think they were counting jobs rather than making jobs count.

Good economics is often counterintuitive. This may shock you if you haven't thought about it before, but progress can best be measured by job losses, not job gains. Many years ago, 90 percent of our population was needed on the farm to produce our food. Now we produce more food with less than 3 percent of the population. That's called productivity. The difference between 90 percent and 3 percent doesn't represent an army of unemployed farmworkers; it represents people working in other industries, many of which didn't exist only a few years ago. That's called progress—progress measured by the reduction in farm jobs. A good thing.

The battle between good intentions and good outcomes in the long run is an uphill battle. Can't you just imagine the last episode of the *Little House on the Prairie*, when the evil banker brings the sheriff to take possession of the family farm? Have you ever seen a TV show or a movie where a banker or a businessman was the good guy?

The productivity revolution in farming has proceeded so far and for so long that most of us can appreciate it even if we do have a soft spot for the family farmer. But the same thing has been going on in manufacturing. We keep producing more and better manufactured goods, but manufacturing employment is flat to down. The productivity boom of recent years has been led by manufacturing as we keep producing more output with fewer workers. The decline in manufacturing employment is a bad thing if you are one of those squeezed out or a good thing from the macro perspective of raising our standard of living. But which is the more moral thing? I would opt for long-term progress, which expands our incomes and enhances our lives over time, with appropriate assistance to those squeezed out.

Similar considerations confront small towns about to get their first Wal-Mart. Dislocation short term. Higher standard of living long term. Which is right? What is the right thing to do? Let people decide for themselves by voting in the marketplace, where their individual preferences prevail. Not in the political marketplace, where power prevails.

If you understand the magic of the market, you don't have to choose. You can have good intentions. And get good results.