Address by Dr. Mark Willes, President, Federal Reserve Bank of Minneapolis, at the October 25, 1977 Annual Meeting of the Minnesota State Council on Economic Education.

Like many of you, I have been involved in economic education my whole life, and one thing I learned was that you are always supposed to preassess your class before you start to teach so you know where you stand before you teach. The way you do that is usually by asking questions. I have one simple question I'd like to ask before I start, and that is, how many of you have ever heard me speak before?

I stand here tonight in place of Bruce MacLaury, who was my predecessor and has gone on to Washington. Since you haven't heard me speak, I will tell one story that is I'm afraid all too painfully appropriate to my being here tonight. This is a story about the Quaker meeting in Pennsylvania, which is where we spent the last ten years of our lives, and the man who was supposed to sing got sick. They asked someone else to take his place just the way I am taking Bruce's place tonight. He was a little reluctant to do it, but he finally said he would. He did just an awful job. He forgot the words and sang off key. It was just terrible, and he felt very badly about it. One member of the congregation, in an effort to cheer him up, came up to him and said, "Thee should not feel bad, thee did thy very best. Tis he that asked thee should be shot!"

I'm going to talk about economic education. It's something in which I have invested a large part of my life and it's something which I have some very strong feelings about. That is particularly true since I am now on the other side of that and am subject to the statements, criticisms, etc., which take place when we have inadequate, ineffective economic education. Now, I have learned a couple of things since I've been involved in the venture. First, I've learned that I, and perhaps you, too, have to be just a little bit more humble about what we teach. When I started teaching at Columbia University and the Wharton School at the University of Pennsylvania, I was convinced on the basis of my training in economics that basically the Keynesian view of the world was right. Therefore, I told all of my students that that's how the world worked. If they could understand that, they could analyze most problems. I then moved to be Director of Economic Research at the Federal Reserve Bank in Philadelphia. As I watched the economy perform and as I watched our attempts to influence the economy, I decided that the Keynesian system just wasn't adequate to explain the problems that we faced. I became convinced that what we now call monetarism was the best approximation to our understanding as to what the policy could do and how it would impact on our economy.

That was fine until I came here to Minneapolis. I now have a staff who says that both of my former views are wrong. It is really the rational expectations view of the world that describes how things work, and they almost have me convinced of that. It may be that I've been a little bit more wishy-washy than most, but I think that the kind of intellectual evolution that I've gone through, to a rather remarkable degree, approximates the kind of evolution that is taking place in economic professions.

If we have finally reached, as my staff keeps telling me we have, the rational expectations view of the world we now really understand how things work, and that's the end of the line, then we can all stand up and say, "Now students, here's how things work," and we can count on it. I suspect that since we all have a few more years to live somebody is going to come along and say that's a silly way to look at the world. Here's another way that displays it better. Five years from now we will be using that method to explain to students how the economy works. I gained from that a rather large dose of humility in terms of what I tried to inflict on others as I explain my views as to how the economy works. I nevertheless feel quite free to inflict my views until someone changes my mind.

The second thing I've learned about economic education is what a big job there is to do. I can't help but think of a story about Winston Churchill, who was quite fond of his nightcap. One day in his reclining years as he was having a nightcap at 2 in the afternoon at a good friend's house: his friend looked around the very large room and said, "If you took all of the whiskey that you consumed and put it into this room, it would come all the way up to the first pane in the windows." Winston Churchill examined the distance between the first pane and the ceiling and said, "Oh, so much left to do and so little time to do it." That's how I feel about economic education when we see the general level of economic understanding that we have and the serious problems that we confront. There is so much to do and so little time to do it.

Therefore, I'd like to take a couple of minutes to cite what to me are two rather compelling examples of what I mean and why I think the job that you're engaged in is so significant. Some of the things I say may offend some of you, and I apologize for that in advance. Let me also say that that's an inherent part of the education process. I once had an outstanding professor. As we were sitting around getting ready to write our dissertations, one of my friends said, "How do you write an unbiased book?" He very appropriately answered, "There is no way to write an unbiased book. No matter how hard you try, your own biases are going to come through what you write or what you teach. The important thing is to make sure that you have access to an unbiased library."

Tonight, I'm going to present a biased book. I am sure that you will want to follow-up with someone else from another part of the library who can explain the alternative point of view.

Let me first discuss the minimum wage. Congress recently passed legislation that will result in the minimum wage going up by over 45% in the next four years. The economics profession agrees on the following set of facts relating to those kinds of inreases in the minimum wage:

1. There is almost a unanimous concensus in the profession that increases of that kind will exert significant upward pressure on prices. The reason for that is very simple. If you move the minimum, the base part of the wage structure, everyone knows that when labor and management sit down together one of the key things that has to be done is to maintain the differential between where my job previously was and where my job now is. So when you move the minimum, almost automatically you end up moving the entire wage structure. If the minimum wage has moved by over 10% a year (average over the next four years) then it's not too far fetched to suppose that the whole wage structure is going to move by a corresponding amount. That's not exactly true, but for the sake of discussion, let's assume that it is. That would mean, other things being equal, wages are going to go up by 10%. If productivity goes up by 2%, that means human labor costs will increase by 8%. If they increase 8% per year, then it's virtually impossible to think of an inflation of less than 6%, which is

what we now have. In fact, it seems more likely to think of inflation as closer to 7 - 8%. By that kind of change in the minimum wage law, almost as if nothing else took place, you would expect to see significant upward pressure on prices. That's a fact that really has a remarkable concensus within the economic profession today.

2. In the process of increasing that base rate, the required wage, thousands of people will no longer have an opportunity to work in the private sector. Jobs will just not be made available to them. Even the Secretary of Labor suggested that the increase that will take place in January 1978 will cost about 90,000 jobs. Our estimate is closer to 200,000 jobs. Those are primarily the jobs for the young and the unskilled and minority groups. The very people that we need the most to get into the labor force to gain experience and skills to be a viable part of the economic system. Again, there's very little difference of opinion within the profession that that will take place.

Why then, with those two facts essentially agreed on by the economic profession, did the legislation pass? It may be that we just have very greedy, barbaric labor leaders who, recognizing these facts, still wanted to go out for the benefit of their members and see the legislation pass. I don't think that's the case. It may be that it was just some greedy politicians were trying to buy votes at the expense of the public, but I don't think that's the case either. That doesn't correspond with my views of the politicians that I know. I think, unfortunately, it's just a very clear example of a lack of understanding on the part of most of the public as to those facts the economic profession just takes for granted. Let me cite an example: A good friend of mine, who happens to be black and lives in an eastern city, received a phone call before the legislation started going through the congressional mill. I said, "Do you realize what's about to happen to your people?" He said, "No, tell me." So I explained these basic facts that I sent to him. My friend said, "Good grief! We can't have that." Unfortunately, my efforts and his were too little and too late to make a change in the outcome. That seems typical to me of what takes place repeatedly. Many people don't really understand the basic economic fact that you and I just take for granted. It seems to me that's a fundamentally important responsibility of economic education to make sure that those facts receive broad public understanding. This issue is going to come up again four years from now when the current legislation is complete. Hopefully by then you and I will have sufficient success to secure a better outcome than the one we have received this time.

I would like to talk about the problem of inflation. I'd like to say that there is a professional consensus on this as well, but unfortunately many of my good friends have not yet seen the light. It's a very serious problem and it has to have a significant increase in public understanding if we're to have the kinds of public policies that would be necessary to deal with the public. We in the Federal Reserve find that skateboarding is the only thing that is universally plotted. When we talk about monetary policy, we tend to lose half our friends depending on what we say. We have recently had our hands slapped by the White House. They issued a statement saying that we just better not try to bring down the rate of growth, or have interest rates go up any higher because we're going to choke off the recovery and cause umemployment. At the same time, we're getting a very strongly worded letter from an outfit called the shadow open-market committee, money is growing much too fast, and we've got to bring the rate of growth of money down significantly or there will be too much inflation, causing unemployment. They can't both be right.

I'll tell you who is right, then you can tell me who is right. My view is that we now know enough about the economic system to recognize that there really is no trade-off between inflation and unemployment. We can't buy as we used to think we could a little less unemployment if we're willing to have a little more inflation. It just doesn't seem to work that way. In fact, what we find is that the more inflation we have the more unemployment we have. That's not very surprising because inflation does essentially three things: it creates uncertainty, it creates misallocation of resources, and it creates distortions in the way the economic systems works. As a result, rather than buying a reduction in unemployment with inflation, we aggravate the very thing we're trying to solve. That's why most of us in the Federal Reserve System think that in spite of what the White House would like to have us do, we think it's fundamentally important for us to stand against inflation. In order to do that, we're going to have to bring down the rate of increase of money. Yes, in the current environment that's going to cause interest rates to go up. But my view is if we don't do it now, we're going to get more inflation and higher interst rates and higher unemployment in the future.

A primary responsibility of economic education is to make sure that we understand at least what the alternatives are — even if we can't agree.

Let me conclude with the following observation. We have been referred to as being a part of the dismal science. Many of us try very hard to overcome that image by making economics interesting, clear and happy. That's the only way we can communicate and have others willing to listen. I hope that we will not forget that fundamentally in the real world we are dealing with hard choices. There is no free lunch. There are competing demands for scarce resources. There is no easy way to solve any economic problem without somebody or something having to pay the cost of that solution. We can't let anyone have the impression that there is an easy solution to any of the problems we face. Instead, we have to help them see clearly the alternatives so that together we can make the trade-offs that seem to make the most sense. I would hope that through your efforts and mine we can accomplish two things: 1)we could lower expectations as to what can be done, and 2)we would substantially increase our performance in terms of what we actually do. If we can do those two things, through economic education and understanding, I think we will have contributed more than our share to the public welfare.

QUESTIONS AND ANSWERS

Q: Walter Heller...

A: Walter Heller and I have a number of differences of views. We are currently running a federal deficit for next year about $60 billion. In my judgment that's far too high to begin with, I wouldn't want to add any more to that. I don't think the economy needs it. The economy is very strong, and we will expect to see real economic growth next year to be much stronger than most people expect. If for no other reason, we have put an awful lot of money into the system and it's going to take time to run short. The only thing in my judgment that's going to make the economy really turn down is if we have inflation starting to run away from us. That's going to make people nervous and we will have a serious problem.

Q: What's going on in the stock market?

A: My grandfather was a druggist in Utah. The way they used to sell stocks is that a man would come around with a bunch in his portfolio and sell them. One day one stock salesman came into my grandfather's drug store and said I have two very good stocks that I'd like to suggest you buy. One is for a new firm called Coca Cola and the other is for a new firm called Wino. My grandfather bought a lot of Wino stock.

My view of the stock market is very simple. Investors have finally learned that inflation is very bad for business. They have a much more critical view of the prospects of inflation than most other people do. You will not, in my judgment, see the stock market turn around and convince the people that we have inflation under control.

Q: What's going to happen to Arthur Burns?

A: I don't know, and I don't think Carter knows at this point. It will depend an awful lot on what the economy looks like in January. His probability of being reappointed has gone from about 75% down to below 50%.

Q: Many people asssume that inflation at 5 or 6 percent is imbedded and there is nothing we can do about it.

A: I think if we give into that idea, we'll have 8%, and if we give into 8%, we'll have 10%. There is no single example in this country or any other country where we have been able to permanently stabilize the rate of inflation at any of those numbers. It is precisely that kind of thinking that puts in the kind of activities that results in accelerating inflation. If I assume we're going to have at least 6% inflation, how am I going to price my products? We'll have to start with a minimum of 6% to get more. If I assume that I'm going to have 6% inflation, how do I price my labor? I've got to start with a minimum of 6% and get whatever amount I can. In the process of getting that little bit more in each piece along the chain, we move from 6-7. We just start the process all over again. I would hope that if nothing else, one of the things we can rule out is that kind of psychology that says we're going to have to live at 6% because, unfortunately, I don't think we can.

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