Markets Versus Bureaucracies: Which Can Best Solve Our Economic Problems?

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As a bureaucrat, I find the subject "Markets Versus Bureaucracies: Which Can Best Solve Our Economic Problems?" an intrinsically fascinating one. To begin, I'd like to tell you a story that was told to me by another bureaucrat, Los Angeles Mayor Tom Bradley.

Bradley's story was about Jonathan in Biblical times. Jonathan was walking along on top of a very high mountain on a beautiful summer day, and the scenery was just spectacular. He was enjoying himself so much that he lost track of where he was, and he fell off a cliff. Fortunately, before he fell all the way down, he grabbed hold of a little tree that was sticking out from the side of the cliff, and he hung on for dear life. He looked down 2,000 feet to the boulders that waited for him, and he realized he had a problem. Now Jonathan knew there was nobody else at the top of the mountain, but in desperation he called out, "Is anybody up there?" And, miraculously, he heard a voice. The voice said, "Yes, Jonathan, I'm here." Well, this was encouraging, so Jonathan asked, "Who are you?" And the voice said, "Jonathan, it's the Lord." Well, now, Jonathan was really excited. He knew he had found a real source of help, so he called, "Help, help!" The Lord said, "Yes, Jonathan, I can help you, but you have to have faith." "Oh, I have lots of faith," said Jonathan. The Lord replied, "Well, if you have faith, let go of that branch." Jonathan looked down 2,000 feet to the boulders below and asked, "Is there anybody else up there?"

I'd like to suggest that very often when people make suggestions to solve our significant economic problems — even though the advice or the offered help may be the very best available — our all too frequent response is, Is there anybody else up there? Is there another way to do it? We respond that way because we don't like to take the risk
that is associated with following difficult proposals. And it's from that perspective that I'd like to spend just a brief time talking about markets and bureaucrats.

THE REAL ISSUE: MARKET SOLUTIONS VS. GOVERNMENT INTERVENTION

Let me state, first of all, that I really don't think bureaucrats are the issue. Granted, the stereotypical view we tend to have of government bureaucrats is of someone who, when in charge, ponders; when in trouble, delegates; and when in doubt, mumbles. It may come as no great surprise to you that that's not my own personal view of bureaucrats.

I find that, by and large, bureaucrats are dedicated, they're diligent, they're hardworking; in short, they're quite competent. More and more, in fact, we see bureaucrats in government functioning like professional managers and employees any place in the country.

Just to take one example I know a little about (and I think I could find many others): if you look at productivity improvements in the Federal Reserve System over the last four years and use that as a measure of some kind of managerial effectiveness, the results aren't too bad. For the Federal Reserve Bank here in Minneapolis — and I can use this figure because I had nothing to do with it — productivity in the last four years improved by 5.6 percent, which is almost twice the national average. For next year our plan calls for an improvement in productivity of something on the order of 11 percent. For the Federal Reserve System as a whole, productivity over the last four years has improved by 6.5 percent per year. Again, more than twice the national average.

You can say we started from such an awful base that we can get those nice big numbers with less difficulty than would the private sector and, in some cases, that's true. The point I'm trying to make is that in government you now find more and more professional managers doing a professional job.
So the issue really isn't markets versus bureaucrats; the issue is really one of markets' solutions to problems versus governmental intervention in problems.

THREE PROPOSITIONS AFFECTING GOVERNMENT INTERVENTION

I'm not going to talk about the many good things which governments do. I'm sure there are some. Some day I'll find them. Instead, what I want to do is talk about some of the difficulties that I see. I will start with three very elementary propositions which I think are kind of fundamental. I'll then talk about some case studies which I think provide evidence with regard to those propositions and then some conclusions that I've reached based on that evidence. I'd like to present all of that more in the form of discussion — opening the dialogue — rather than as final answers, because I'm really not sure I have the final answers — in spite of what people think when they hear me talk. I do have an open mind on many of the issues that we face. But, by the same token, I find the evidence that I look at more and more compelling each time I examine it.

The three propositions that I think are relevant to the issue of government intervention in economic problems are:

Proposition #1
The economy is very large and complex. Therefore, economic problems tend to be complex.

Proposition #2
A governmental solution to a problem requires widespread understanding and support for the solution.

Proposition #3
Self-reliance is fundamental to a happy, satisfying life and is a key factor in determining the energy with which individuals pursue economic or other kinds of activities.
Those are very simple statements. I suspect if we were to discuss them, we would find very widespread agreement on each one of them. Everybody knows the economy is very large and complex and that the solutions or problems we face tend to be very complicated and require very complicated kinds of solutions. It is a truism that in a democracy you have to have the consent of the governed in order to do what you do. There are also some economic reasons why you have to have consent. I think it is also true that most psychologists I have talked with indicate that human potential is achieved, human energy is exercised, primarily on the basis of self-initiative: Something that happens inside individuals rather than something that is imposed on them externally. So, essentially what we have is an economic statement, a political statement, and an individual or psychological statement.

In my judgment, in order to satisfy any economic problem, we need to satisfy all three of those propositions. We can't just look at the economics, we can't just look at the politics, we can't just look at human psychology; we have to look at all three and deal with all three if we are to have effective solutions to problems. And it's been my experience that it is when we leave out or ignore one or the other of those propositions that we get into difficulties and generate solutions to problems that, as often as not, make the problems worse rather than better.

CASE STUDIES: WELFARE, HOUSING, INCOMES POLICY, ENERGY

Well, let me go through a few of what I call "case studies" relating to governmental intervention in our economy. Some will say that the selection I have made is biased; yes, it is, I'll admit that right up front. But I think these examples have a very important story to tell in terms of how we approach the very real problems we face today.

To begin, let's look at the welfare program. The problem, of course, is poverty. The proposed solution, simply enough, is governmental assistance payments to those who are in poverty. What have been the results? Well, I won't go into great detail
on results because this case is so well known and so agreed to, that I don't need to belabor the point. But I do want to remind you of the facts, because I think it's part of the story we're talking about here. First of all, the studies that have been done show that there has been essentially no reduction in poverty as a result of the welfare program. So if you look at the bottom line, it didn't succeed. That's particularly unfortunate because the cost of the program has been enormous. The economic cost — the dollar costs — have been huge; there have been substantial disincentives with regard to work, and as a subsequent decline in national productivity and efficiency. The personal or human costs have been even greater. Many psychologists and sociologists who have done credible studies in this area, have pointed out that the welfare program — the way it's been administered, the way it's been conducted — has resulted in large disincentives with regard to family structure. In turn, those disincentives have resulted in tremendous social and political costs. In terms of effects on individuals, there has been a wholesale destruction of what might be called self-reliance, self-initiative; we now have literally generations of people who are so dependent on the welfare system that their own individual initiative is completely destroyed. I would suggest that that's a cost of rather enormous proportions, both to society and to the individuals involved.

Often when we think of the welfare program, we think of New York or some place where welfare programs are concentrated and visible. But the impact of these programs tends to be almost exactly the same — whether in New York, South Dakota, or North Dakota. Someone whose judgment for which I have a very high regard, told me that during the 1930s he was given the job of being the county agent for the dispersal of welfare funds in a state in this District. When he first started, peoples' reaction was that it was a shame to take public assistance — income assistance — payments from the government. They just wouldn't do it. But, without too long a time passing, somebody in the community decided that either they really needed the money, or they wanted to take
the money, so they did. In a matter of one year, the environment in the community had
gone from one in which residents had absolute disdain for these income payments to one in
which residents felt "it's my right to receive those kinds of payments because my neighbor
got them." The result of this change in attitude was a significant dispersal of funds
without a real pickup in the rate of economic activity in the area. But there were some
rather interesting sociological changes and individual changes: changes in the feelings
people had about themselves, about their neighbors, about their right to government
assistance, and changes in family structures. One of the ways people in this particular
three-county area were surviving during this period was by having multiple generations of
families live together — grandparents, parents, the kids. Well, with public assistance
payments, everybody had their own place. They weren't earning any more, they weren't
producing any more, so the net result was simply an increased level of government
spending to maintain three separate families rather than one combined family.

Let me try another example where the results aren't quite so well-known —
although there is a pretty strong professional consensus on this now — and that's the
housing problem in New York City. I pick New York because it tends to be so global that
you can see everything at once.

Problem? Inadequate housing. Solution? Public housing. What can be simpler
than that? The results? Very interesting. It is not at all clear that the quality of housing
went up, even though there were literally thousands of substandard units destroyed and
new units built. Two things, however, are clear.

First of all, when the initial substandard housing was razed, those who had
lived in that housing simply crowded into housing that had not been substandard. So during
the construction process, what we did was to take substandard housing and eliminate it. In
the process of doing that, we took housing that wasn't substandard and, through over-
crowding, made it substandard. So when we put up the new housing units, overall housing
quality hardly changed at all.
More importantly than that, after spending billions of dollars of public monies to "solve the housing problem," what New York found was that they had created a social disaster. For those of you who know anything about New York, you know that it was, in spite of its size, essentially a neighborhood city. When people migrated to New York, literally from all over the world, they would tend to go to that place in New York where previous emigrants from their country had settled. So there were all kinds of ethnic neighborhoods throughout the city of New York with their own culture, life style, and economic base. These were relatively cohesive and, in many ways, kind of nice communities. Well, when they knocked down the housing, they completely obliterated those neighborhoods. And when they put people into the public housing, there was no way they could reassemble the sociological and cultural environment that they had destroyed.

The result was, in my judgment, absolutely heart-rending. There are many tragic stories to be told about older people, sitting in these nice new apartments, deciding to die because all of their friends were scattered and the whole environment that they had been used to had been destroyed. And nice, cleanly painted walls just could not make up for the fact that friends and social exchange patterns had been obliterated by this program. Middle-aged people found that the complete disruption of social patterns resulted in alienation from the city that had been a relatively warm friend. Young people were so uprooted that gang organizations became enormously powerful and enormously destructive.

So once again, as far as we can tell, spending large sums of public money to solve an economic problem resulted in practically no improvement in the economic facet of the problem and, in fact, resulted in enormous social and individual costs.

Well, a different kind of case study: a thing called incomes policy. Problem? Inflation. Proposed solution? Simple: wage and price controls. Results? Well, yes, there was indeed a temporary restraining influence on measured wage increases and price
increases. I say measured, because it is perfectly clear that one of the things that happened was that measured prices and transaction prices began to diverge rather widely. And you know as well as I do that there is an infinite variety of ways that one can pretend to sell something at the same price but, in fact, change the amount, the quality, or other characteristics relating to that transaction and, in fact, make it a different effective price. The econometric studies that have been done since the controls were released have demonstrated, at least to my mind, that while there were some results on a temporary basis, these results were essentially eliminated once the controls were removed. We didn't really gain anything, as far as I can tell, and most other economists would agree — certainly not all but most — we didn't gain anything in terms of reducing inflation. We surely did accomplish some other results, none of which could be considered desirable: we built serious distortions, bottlenecks, and shortages into the distribution and production process. We have already forgotten, much to my surprise, the kinds of lines that people had to stand in and the shortage of key materials — many of which were associated with the fact that we had put a lid on the price and, therefore, supply for that particular good dried up.

In addition, we incurred significant costs just to administer that program. I was down in Washington while we were trying this grand experiment. Some of you have heard me tell the story of the day I was sitting in a meeting of the Cost of Living Council, which was the master group managing wage and price controls. That group consisted of about four members of the President's cabinet and other top governmental officials. This particular day, all of these high government officials were sitting around the table, and for 45 minutes they discussed the following question: Is a man's shirt with a monogram a different product than a man's shirt without a monogram? That was a very important question, because if it were a different product, the shirt with a monogram was subject to
a whole different set of rules and regulations than if it were the same product as a shirt without a monogram.

The point is, there is no such thing as general wage and price controls. As soon as you start down that road, everybody has an exception that has to be dealt with. And, as you build up the rules and regulations dealing with that exception, you end up with a mountain of pamphlets describing the various rules and regulations relating to thousands and thousands of products and services.

Well, if you think of not only the governmental time spent on writing those regulations, but of businesspeople's time and others' time figuring out how to comply with regulations or how to get around them, you can see the enormous waste of effort and energy having to do with that kind of administrative program. In addition, we saw the beginning (and fortunately it didn't last long enough to become a real problem) of what I call the prohibition syndrome. As in the days of prohibition, people were beginning to wonder whether or not the thing made any sense at all and therefore began to feel, "If we can find a way to avoid it, we'll do it." In a democracy, I suggest, that is a most unfortunate kind of feeling to have. Again, the result of government intervention? Little if any impact on inflation, very high costs in terms of misallocation of resources, and a significant loss of personal freedom.

Well, let me try one more — the list could go on and on, as you can imagine. I'll take one that's close to the Upper Midwest Council, because you spend a lot of time talking about it. I'm probably going to step on some toes here, and I apologize for that. Case in point: Energy. Problem? Fuel shortages and the heavy import of foreign oil; I mean, that's really what people are so concerned about these days. Proposed solution? The best characterization of the proposed solution I've seen is Jeff MacNelly's cartoon about General Washington sitting in the tent at Valley Forge. A soldier comes running in and says, "General, we're almost out of firewood." Washington answers, "Quick, tax it."
Well, that in essence is the administration's proposal to solve the energy problem: We're running out of fuel — quick, tax it. Kind of strange, to my sense of logic, to think that's going to solve the problem. If the program passes, there will be some conservation as a result of the higher prices. There will also probably be continued U.S. support for OPEC. When historians write the story about the oil cartel, in my judgment, it's going to be perfectly clear the only reason it succeeded was because the United States supported it. How do we do that? We do that by allowing domestic energy prices to be held artificially low and encouraging OPEC to hold their oil supplies in ransom. If we persist on that road OPEC has a very long life indeed. If we didn't, we would already be seeing the demise of that particular international cartel.

Another potential consequence of the proposed energy program, in my judgment, will be a serious misallocation of resources. I find the whole energy question so incredibly complex that I don't know how anyone can say, "What you really should do, businesspeople, is burn coal," and then force people to convert to coal. I can't help but think that in the long run we are going to look back and find out we made some very bad mistakes in that regard, and we'll have wasted enormous sums of money converting back and forth based on what some study says we ought to do.

More importantly, we will have deprived ourselves of the kind of market incentives that we need to make other sources of energy economically viable. By other sources, I include additional recovery of oil and gas that is not now economically viable to recover and, in addition, things like solar energy — maybe even grain energy. Obviously, it is not economically viable at the moment to grow wheat and turn it into alcohol, but it is not at all clear to me that there isn't some price at which that would be economically viable. The implications for this District are rather interesting in that regard.

Well, again, in my judgment, if the proposed energy policy is followed we not only won't solve the shortage problem and the import problem, but we'll end up with distortions and higher prices as a result.
IMPLICATIONS OF GOVERNMENT INTERVENTION

Let me sketch for you the implications of the kinds of cases I have considered.

First, it seems apparent to me that we have had a large number of failures resulting from government intervention in the economy. I've concluded from that that the burden of proof should be on those who argue for government intervention to solve a problem rather than — as it happens to be at the moment — those who argue against government intervention. It seems to me, if we take a little look at history, that there are so many conspicuous failures littering the landscape that we really ought to rethink who has to prove what.

Second implication — naive, not at all novel, but in my judgment very important — is that we, as a people, just must lower our expectations as to what we think can be accomplished in solving the economic problems that we face. Very often our attempts to try to improve things make things worse, rather than better, and we would all be just a lot happier if we didn't keep promising each other things that we really can't deliver on.

Third, I think we need to explicitly recognize the complexity of the economic problems that we face. Both in terms of their economic complexity and in terms of interaction between economic, social, political, and individual values and concerns. We ought to have the courage, if a problem is too complex for us to understand, to say, "we don't understand it; therefore, we're not going to meddle with it." Very often when we take simplistic solutions to complex problems we end up making things worse rather than better.

Fourth, the implications that I draw from the cases I've outlined are that we have to do a much better job of giving explicit recognition to the fact that the success or failure of virtually every economic program that we attempt depends on those programs' intensely personal impact on individuals and how individuals react. We really have to start
thinking about what happens to people when we start talking solutions. If, for example, a proposed solution to a problem results in a loss of self-reliance and initiative, in my judgment it's a destructive program and ought not to be implemented.

I was having a discussion the other day on a similar topic and was reminded that when some of your wives were having children, it was standard procedure after delivery for the woman to stay in bed for a week. The idea was that it was painful and destructive to get up. So women stayed in bed for a week and maybe in two weeks they got home from the hospital. Today, within a few hours after the mother comes out of the recovery room, a nurse comes around and says, "Okay, let's go." Typically, the mother will say, "No, it hurts; I don't feel well." Nurses have no sympathy; they just grab the mothers by the hand and start walking them down the hall. As a result, because of the initial ache and pain and stress, mothers get out of the hospital in three days rather than two weeks. They heal significantly faster and the medical complications as well as the psychological complications are much less. It seems to me that we need to consider the possibility that sometimes stress and difficulty and pain can produce therapeutic results. And it ought not be a function of government to eliminate all pain and suffering, because in the process we may eliminate a lot more good things than we do bad.

Finally, as I've stated, if a proposed policy goes against the perceived interests of a large proportion of the citizens of this country, then we just have to avoid it. The reason for that is not only that in a democracy we should have the consent of the governed in order to accomplish the policy, but the fact of the matter is that if people don't perceive the policy to be in their interest — as would be the case in the current environment with an incomes policy — they will spend enormous amounts of money and energy finding ways to get around it. And because of that we will get a tremendous waste of resources and distortion in economic decisions will occur. And with more and more
people dividing into interest groups — everybody now seems to be a member of a self-interest group of one kind or another — it just strains my imagination to think that we're going to get a harmonious, happy, resolution where everybody agrees on a common solution to many economic problems. If that's right, then it follows that more and more things that we try to do are going to result in more and more attempts by people to obstruct the intent of the program.

THE MARKET SOLUTION

Well, if these implications are significant, it seems to me that we would be far better off trying to find ways — instead of replacing the market mechanisms or interfering with the market mechanisms — to structure the market so that these tremendous personal incentives and motivations can be used to generate the social solutions that we are interested in. I think there are some ways of doing that, but that's a whole other talk that we won't have time to get into today. Let me read you a quote from a bureaucrat that I found fascinating — a New York City bureaucrat, by the way. He says, "Anyone who struggles with rent control regulations develops a respect for the free market that verges on downright awe." The point is, it might be interesting to see what would happen — what kind of energies would be released, what kinds of results could be accomplished — if instead of trying to interfere with the way the market seeks to generate solutions, we simply tried to structure the market and build in the right kind of incentives so that personal energies could be channeled in such a way to produce socially desirable results.

Let me conclude by suggesting that probably everyone in this room would agree that addictive drugs should only be used in very exceptional circumstances and that a majority of the people who use addictive drugs in order to alter their moods, or to look into themselves, or to have visions — really are using a most destructive means to
accomplish the results they are seeking. In fact, people who become chemically dependent very often not only have very destructive things take place physically and psychologically, but they tend to end up aggravating the very problems they thought they were trying to solve. I would like to suggest that in this country we are, more and more each year, trying experiments of governmental intervention that run the serious risk of making us governmentally dependent, just as drug addicts are chemically dependent; and that we will experience precisely the same kinds of results and consequences if we don't reverse that trend. That is to say, we will become so dependent on the government to solve our problems that (1) we will not look to our resources to solve those problems, and (2) in the end, we will find that we have aggravated the very problems that we are trying to solve. I am distressed by the persistent stream of businesspeople, labor people, farmers, consumers — literally every group you can imagine — asking the government to come in and solve their particular problem. It's not an isolated phenomenon, it cuts all across the board, and I would like to suggest that if we in fact become — if we're not already — a governmentally dependent people, the cost to us in economic, individual, and social terms will be enormous. I think it's time to consider the alternatives.