

ECONOMIC IMPERATIVES OF THE SEVENTIES

Remarks by
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It is a pleasure to be here and to discuss with you the economic problems that face us in the seventies and some possible solutions that may be offered. Unfortunately, I find it difficult to talk about imperatives. An imperative, as I view the term, is a goal which must be achieved, and if I were to propose such goals it would imply that I know what is best for all of society. I do not care to claim such knowledge.

Talking about the economic effects of achieving these goals, however, is an entirely different matter. A very serious problem resulting from discussions of imperatives is that those who set them forth all too often completely ignore the costs involved, including those which cannot be measured in terms of dollars and cents. Glaring examples of this phenomenon are offered by many of the current proposals for pollution abatement, higher safety

standards, minimum housing, dietary and health standards. A less obvious one is the ever more popular attempt to provide free advanced education to everyone.

The economic considerations of meeting an imperative evolve from the process of allocating and utilizing scarce resources. I would like to underline the word scarce because this implies that actions undertaken to achieve a newly adopted imperative require a transfer of resources from one use to another.

In this context any assertion of an imperative means that one knows the gains to some derived from achieving this imperative, that one knows the losses accruing to others, and that one can weigh these gains and losses and come out with a situation preferable for the community. It is obvious that neither I nor anyone else can make such an evaluation; therefore, to state some goals as an imperative appears to me to be foolish. Alternatively, it is the ultimate in elitism, since one would be saying that he does not care whether people prefer the result or not; he knows better than they what is good for them.

Recently, an interdisciplinary scientist of the RAND Corporation, in complaining about the problems of interdisciplinary research, stated that economists seem to know about prices but know nothing about values. And that is true indeed. If values are measures of satisfaction, then we all presumably know them for ourselves but don't know them for others. Nor, for that matter, does the RAND scientist.

Given all this, it would be presumptuous for me to claim, on the basis of my profession, a superior competence in setting forth economic imperatives. I should, therefore, conclude my talk now and sit down, but that would be too simple, because there is increasingly wide discussion of social and economic imperatives. If such goals are set and achieved, we hope that benefits will accrue and we generally acknowledge that some costs will be involved. Apart from pointing out some of these costs, I should like to talk about the process of achieving these goals and to consider some costs and complications attached to the process itself.

In a society characterized by private property and freedom of choice, individual goals - their own imperatives, if you will - are revealed by the market mechanism. For example, if some members of society were to decide that automobile emissions are truly noxious and that they prefer cleaner air to the satisfactions derived from driving large cars which pollute the air, they would choose to buy bicycles or cars which cause minimal pollution. And this would set into motion a whole series of events with a myriad of repercussions. These repercussions would be greater the larger the number of individuals exhibiting this preference.

The prices of bicycles and small cars would rise, as would the profits of their manufacturers. Expanding production would lead producers to offer higher wages and returns in order to bid labor and

capital away from other uses, most notably large car manufacturing, which in turn will offer fewer jobs. In this way resources are allocated according to consumers' desires.

To be sure, this process is not without frictions and costs: there would be a redistribution of wealth from large to small car manufacturing; labor, in the process of moving from one employer to another, may become temporarily unemployed; if the small car manufacturers are primarily foreigners, we would experience an import surplus and thus balance of payments difficulties. But the net effect would be that the society got what it wanted.

In this sense, of course, diverse social goals are achieved virtually automatically and there is no need to discuss them. It would seem then that goals become imperatives only when those who propose them feel that too few people share those goals to bring about the desired results. Please notice that I am not saying that any proposal of an imperative is a case of the minority attempting to impose its will on the majority. It may well be that to achieve a particular end, a consensus of fewer than 95 percent constitutes "too few people."

Consider the case we were just looking at, namely, that of automobile-produced air pollution. It seems pretty clear that almost everyone talks about the desirability of cleaner air; yet large, pollution-spewing cars continue to be sold in considerable numbers. This does not make us all hypocrites. Suppose 60 percent of the popu-

lation agrees that having small, less powerful, less luxurious cars is a reasonable price to pay for healthier air - surely this 60 percent would include nondrivers who pay the price of breathing smog without receiving any benefits. It may well be that if only the drivers in this group - clearly the majority - shifted to small cars, the reduction in pollution would not be worth their inconvenience. That is, some big-car buyers might willingly shift if they knew that everyone else would go along, thus making their sacrifice worthwhile.

In a situation like this, there are other avenues through which goals can be achieved, and these approaches are usually focused upon by those who speak of imperatives. If the political majority agrees or its representatives can be convinced of the desirability of a goal, it can be achieved through a transfer of resources accomplished by political action.

To follow through with our clean air example, the government could simply outlaw the offending models and characteristics. On the other hand, it could, through its powers of taxation and subsidy, raise the price of large cars relative to small cars sufficiently to achieve the same objective. Resources would again flow in such a way as to produce the desired cleaner air. Society has again expressed its desire, but with a very basic difference. The political mechanism has allowed individuals in the community to make a yes-or-no decision, but not to express the intensity of its

desire in terms of the number of people agreeing or the strength of their opinion. And in a very direct way, one group has imposed its will on another.

I do not mean to imply by these remarks that the market process is absolutely preferable to the political process in determining and achieving imperatives. If I were to do so I could be accused - rightfully - of expressing an imperative in terms of processes and thus trying to impose my will on others. After all, every single one of our publicly supported activities is achieved through the political process and we seldom hear a massive outcry against the existence of public education, social security, unemployment insurance, defense, police or fire services. And yet, expansion of these publicly supported services do produce some real economic problems. And as more and more of the so-called imperatives are articulated, problems multiply. Therefore, the remainder of my remarks will highlight some of these problems, which too often are neglected in discussions of imperatives.

The traditional functions of the government, and I do not know whether they are good or bad, have been changing over time and are being supplanted and augmented by new ones. This increase in the government's sphere of influence has been growing steadily and at an increasing rate. This has been particularly true since the depression of the early thirties and the acceleration of government growth has been extremely rapid in the sixties and thus far in the

seventies. It seems to me that this rate of government growth will continue for some time and will produce economic problems which may well be the most difficult we have ever faced.

As long as man can remember, the main thrust of economic activity has been to produce a maximum stream of goods and services in order to improve the well-being of individuals. This has resulted in an astounding growth of income and wealth per capita all over the world. As this wealth was increasing, however, the distribution of wealth did not become more equal, either among nations or among individuals within these nations. It is true that in some economies, the United States among them, the relative disparity has narrowed, but in the vast majority of cases this was not so. A phenomenon which seems to have accompanied increasing wealth has been an increasing reluctance on the part of the members of society to sustain risk to acquire additional wealth. In other words, along with increasing wealth has come the desire for more and more security.

This quest for security has manifested itself in many forms: the demand for assured social roles, for guaranteed employment, for health benefits and education, and, most recently, for a more equal distribution of income. I believe that it is this desire for welfare equality that has given rise to most of the so-called economic imperatives of the past thirty years and particularly of the late sixties

and early seventies. Virtually all of the revolutions of this century have been rooted in the unequal distribution of wealth. Virtually all of our social policies, including the progressive income tax, unemployment insurance, regulation of business establishments and doctors, labor legislation and farm programs, have their roots in the attempt directly or indirectly to equalize wealth. I am not passing a judgment as to whether this is good or bad. I am simply stating my interpretation of facts. I am also not saying that this desire for income or wealth equality is an economic problem per se. What I shall try to point out is that the chosen process for the achievement of this goal will have economic repercussions which are frequently ignored.

As we have seen, the market process which responds to individuals' desires by reallocating resources, does not produce equality of wealth. As a matter of fact, in order to produce this desired shift of resources, some producers must gain and some must lose. Clearly, these gains and losses are not randomly distributed and in all likelihood the result would be an unequal distribution of wealth. Moreover, it doesn't seem to me to be reasonable that individuals in their preferences for goods and services will abstain from buying from an efficient producer simply because he is wealthy.

If all of this is true, the market mechanism will not produce equal distribution of income and no one has ever claimed

that it would. So the desire for achieving this goal has resulted in greater use of the political process and less dependence on the market mechanism. As we know, this is the direction which has been taken in the past and most likely will be used throughout the seventies.

Now let me summarize what I have said. I believe that most of the so-called social and economic imperatives that have been or will be articulated during the seventies deal with some form of equalization of wealth distribution. Since these goals cannot be achieved through normal market channels, we tend to ask the government, through the political process, to achieve them for us.

Reliance on the political process, however, usually has resulted in little attention being given to costs associated with achieving a new imperative. If these costs were known, society may or may not choose to undertake the recommended course of action. The market process incorporates such considerations, although not necessarily perfect enough to suit everyone. More reliance on the political process, and less on the market process, in my view, has great potential for producing results which may be unacceptable to a vast majority.

Let me elaborate. Suppose a law is passed that everyone is entitled to government supported education through the Ph. D. in order to assure that the benefits of advanced education are not limited to the rich. This means that the government will have to

subsidize schools and/or individuals, and, if there is no agreement to reduce other government services, it will have to acquire additional funds. The government then has two alternatives for this acquisition: it can increase taxes or it can borrow by selling government bonds. The increase in taxes is politically unpopular and the political party in power at that time most likely will try to avoid doing so like the plague. Thus they must resort to borrowing.

If they sell bonds on the market and there is no increase in funds available in credit markets, interest rates will rise. As the return on government bonds rises, there will be incentives for lenders to withdraw their money from savings accounts and from other interest-bearing securities in order to buy these bonds. These actions will increase interest rates on all other securities including rates on savings accounts and mortgages.

Now if one of our other priorities is to provide everyone in the society with decent and reasonable housing, the increase in mortgage interest rates will discriminate against those who borrow to get such housing. In short, resources will be shifted from housing, as well as from other activities, to education. Thus the desire for creating economic equality through expanded education is in conflict with the desire for decent and reasonable housing for all.

But all would not appear to be lost to those who govern. There is another alternative: the government can borrow from the monetary authority, in the case of the United States, the Federal

Reserve System. Since the Federal Reserve can print money virtually without limit, it could buy the bonds at whatever price the government wishes to sell them for, thus avoiding an increase in the interest rates. Thus, it would appear that the government could proceed with the subsidy to all those who wish higher education without any apparent cost in terms of other "imperatives."

This scenario is not a figment of my imagination. In the United States the percentage of an ever growing government debt held by the Federal Reserve has risen from 10 1/2 percent in 1952 to 22 percent in 1973. In many other countries, government debt is routinely sold to central banks and never reaches the financial markets.

Unfortunately, in this case the effects do not stop at this point. The central bank pays for government bonds with freshly created money and when the government spends on the newly approved subsidies there is an additional claim on scarce resources. Furthermore, the increase in cash balances of the public induces the private sector to increase its spending. The increased spending - both government and private - will bid up the prices of goods and services.

As I have stated before, the achievement of any economic goal requires that resources be transferred from one use to another. In the case under consideration, resources must be transferred to

the recipients of subsidies. An increase in taxes would have transferred them from the taxpayers according to some agreed upon form of taxation, but taxes are unpopular. Sale of bonds in the market would have transferred resources from lenders, that is buyers of bonds, who do this voluntarily in exchange for a return in the future, but high interest rates are unpopular.

As a result, those who govern frequently turn to the monetary alternative, in an attempt to be popular. Such a choice, however, usually leads to the required transfer of resources through inflation, away from those who sold their goods and services at pre-inflation prices. Examples of these are people on fixed money incomes, those with long contractual obligations, and those who did not anticipate a rise in prices when they sold their assets. I am willing to assert that such a transfer cannot be justified on the grounds of equity, economics, morality or any criterion generally specified.

Now what I am arguing is that most of the social and economic imperatives which have been proposed in the past fifty years and which without doubt will be proposed in the seventies are such that, according to the popular view, they can best be achieved through the political process. I assert further that this process, irrespective of the goals themselves, reflects social and political survival traits and, as a result, produces inflationary pressures.

These pressures redistribute wealth in a way that cannot be defended in any rational way and may well be counterproductive to the imperatives themselves. Moreover, as a result of recent experience, a new economic imperative has evolved for the seventies. This is the abatement of inflation. A severe problem has resulted, however. This new imperative is clearly incompatible, within the present operation of the political process, with those imperatives calling for an increased role of government.

The question arises then as to whether we can do anything about resolving this problem. My answer is, "yes, by improving the political process." If all the proponents of quote-unquote imperatives would clearly state what the estimated cost in terms of resources would be, or if we should demand that they do so, we could accept or reject their proposals with a clear knowledge of the costs in terms of alternative uses of scarce resources. Under these circumstances the government would not have to resort to the subterfuge of shifting the use of resources through inflation. We would pay through taxes what we agreed to pay. There may be arguments about the equity of our tax structure, but at least the result would not be a random redistribution of income which may fall very easily on those who can least afford to pay.