# "FLY NOW, PAY LATER"

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My subject tonight is "fly now, pay later." "Fly now, pay later" is a phrase that was popularized in the 1950's and 60's to promote air travel. First of all, let me assure you that I am not here to promote travel. I am here to discuss economic policy. But I can think of nothing that more aptly describes an attitude that has become increasingly prevalent in economic policymaking than "fly now, pay later." By this, I mean the increasing tendency of economic policymakers to seek short-run solutions to economic problems, while ignoring the longer-term consequences of their near-term actions.

This attitude has disturbing implications for economic policy. First, it causes economic analysis to concentrate on the symptoms of economic problems and to ignore fundamental causes. Second, actions which promise immediate benefits, however temporary, come to dominate economic policy at the expense of concern for future costs. The result for the economy is growing inflation and erosion of our productive capabilities.

There are understandable reasons for this kind of thinking. Many of the issues economic policymakers must deal with are "people problems." Take unemployment, for example, which falls disproportionately on the very people least able to cope. . . the young, the poor and the disadvantaged. It is a problem which cries out for an early solution and it is tempting to overlook the long-term implications of actions which promise to bring early relief to problems which are in need of immediate action.

There are other similar issues which likewise call for quick action. The energy situation is probably the most obvious example, but there are others. Decent housing is a national goal, and rising interest rates have a negative effect on housing. Farm income must be sufficient to maintain the agricultural sector. Growing imports hurt various industries and increase our dependence on foreign producers. The list is endless and all are real challenges worthy of our best efforts.

In most cases, the tendency is to act now. . . to seek a quick solution today. If long-term costs are considered at all, caution often is dismissed with the promise to worry about future costs when the time comes. The sad fact is that we frequently never get around to giving serious consideration to those long-term costs, because each day brings new pressing problems which themselves demand immediate attention. The effects of individual short-term corrective actions pile up until they cumulatively come to dominate the economy as they are now doing, and by that time it is difficult to untangle the sequence of events that created the situation that has evolved.

The very nature of monetary policy and its influence on economic activity makes it particularly attractive as a short-run policy tool. Money can be pumped into the economy very quickly with little necessary lag between the time when a problem is identified, stimulative action is taken and the benefits are realized. The effects of monetary stimulus on output, employment and interest rates are felt very quickly. . . usually in a matter of only months.

But what of the longer-range costs of this kind of action? Economists recognize that accelerated monetary expansion ultimately results in increased inflation. The inflationary effect is delayed, however, often for several years. So, it is very tempting to opt for short-term economic benefits while ignoring longer-term detrimental effects on the rate of inflation.

The very reason the Federal Reserve System originally was given the responsibility for implementing monetary policy in the United States was to avoid this temptation. The intent, and it was a wise one, was to have the Congress determine broad national goals while delegating to the Federal Reserve the responsibility for using the monetary tools of government in pursuit of those goals, free from the pressures of responding to more immediate economic problems.

Despite this intent, however, the Federal Reserve is frequently called on to react to day-to-day economic events. Most recently, the System has been castigated by some economic analysts for conducting what is construed as a restrictive monetary policy. These critics base their arguments on the fact that short-term interest rates rose by 200 basis points in 1977. They complain that rises in short-term interest rates are inappropriate in light of unacceptably high unemployment and the government's concern for maintaining rapid expansion of economic activity. The attitude of these critics is a prime example of concentrating attention only on the short run. It ignores the fact that the Federal Reserve actually increased the money stock at an 8.4 percent rate at the very time that short-term interest rates were rising. Such accelerated money growth has had a significant expansionary effect on economic activity, for a time at least. If maintained, however, the inevitable result will be higher inflation and, ironically, higher long-term interest rates in the future.

To attempt to conduct monetary policy from a short-term perspective is much like viewing the economy as a series of snapshots. Each day a new picture is taken and the economic problems captured on that particular print are identified. All problems identified in the picture are seen as being caused only by other factors visible in that picture. Responsible monetary policy requires a much broader view of the world, both in terms of looking ahead to the future as well as realistically interpreting past events that have led to the present.

The myopic "fly today, pay later" point of view tends to view inflation as the result of short-term secular influences. We hear arguments that inflation today cannot be traced to excessive money growth because there are so many people currently unemployed in the economy. The apparent premise is that monetary inflation is possible only when the economy is fully employed. This view argues that the current inflation is caused by rising costs in general and rising wages in particular. A variation on this theme comes from those who blame inflation on whatever component of the consumer price index happens to be rising at the moment. One month it is food prices, in another month it might be gasoline prices or mortgage interest rates. The list of examples goes on and on.

If we take a longer-term view, we will recognize that the current economic situation is not the result of structural factors such as those I have alluded to, but instead are the logical consequences of a process which began a little more than a decade ago. It began in the mid-1960's when our government chose to increase the amount of resources going to national defense. We all remember the official assurances that the Nation could have both "guns and butter." As defense spending rose with out involvement in Vietnam, other federal spending programs were not cut. Even as the growth of defense spending decreased sharply in the early 1970's, total federal expenditures continued to increase rapidly. Total federal spending last year was triple that of 1966.

Taxes were not increased to finance the rise in spending. Instead, the federal government has been running a series of large budget deficits. Over the 11-year period since 1966, federal debt increased by $270 billion, nearly doubling. If federal agencies and trusts are included, the increase was $350 billion. Deficits such as these have one very obvious side-effect. . . interest rates are pushed up and private borrowing is discouraged, thus allocating additional credit to the government. Policymakers, interested only in the short term, argued that rising interest rates had to be avoided, lest economic activity be restricted. Their recommended solution was, and it is now, expansionary monetary action.

The Federal Reserve actually purchased $60 billion of government debt between 1966 and 1977. Growth of bank reserves accelerated and a sharp increase in the money stock resulted.

With the exception of brief periods in 1969 and 1974, this acceleration in money growth has continued unabated for more than 10 years. From a trend rate of increase of about 2 percent per year in the early 1960's, the trend of money growth rose to 6 percent per year by 1972. That trend has been maintained through today. It is more than coincidental that the fundamental rate of inflation rose steadily from the mid-1960's to 1972 and has persisted at almost 6 percent since. It is not an accident that wage earners' demands now approximate 8 percent per year. It is not coincidental that long-term interest rates rose sharply and currently remain about 8 percent. Nor is it happenstance that the international value of the dollar has fallen.

Unfortunately, the "fly now, pay later" view fails to recognize these types of developments as the public's reaction to inflationary pressures. Rising wages and interest rates, a falling dollar, lack of business investment, and many other problems we face today are symptoms of an inflationary situation. These conditions are neither causes of inflation nor problems which can be addressed separately from inflation.

Current projections show a federal deficit of at least $60 billion for the next 12 months. If the Fed were to pursue actions to hold the money stock to a 6 percent increase over the coming year, net purchases of about $8 billion of government debt would be required. Money growth at a 6 percent rate would be an effectively neutral action, neither stimulating nor restraining production and employment. Short-term interest rates would probably continue to rise under the pressure of heavy government borrowing being superimposed upon the continuing expansion of private credit demands.

Some observers would probably argue that an even more rapid rate of monetary expansion is required in order to hold down interest rates this year. It would require an even more rapid pace of money growth than we experienced in 1977 to hold interest rates down in 1978. If credit demands remain as anticipated and if the Fed were to attempt to hold short-term interest rates unchanged at their current level throughout the next year, an increase in the money stock of at least 9 percent would be required. Approximately $30 billion of new money would have to be pumped into the economy over the next 12 months requiring the Fed to buy at least $12 billion of government debt through our open market operations.

What would all of this mean for the economy? With money growing at a 6 percent rate, the rate of inflation would continue at current rates and aggregate production would probably show from the pace that was achieved over the past three years. This slowing in growth of output should not be interpreted as a sign of actual or impending weakness in the economy, however. Instead, this is the natural consequence of the economy approaching the effective capacity constraints imposed by the energy situation, the evergrowing burden of government regulations and the general level of uncertainty which prevails in the economy.

If the rate of monetary expansion were to be accelerated to 9 percent per year, the impending rise in short-term interest rates could be restrained for awhile. Production growth would be somewhat higher in 1978, reaching about 5 percent over the year. The rate of unemployment would fall somewhat further, to 5.5 percent or a bit lower by year-end. The rate of inflation would not be much affected in 1978, running at about a 6 percent rate.

The ultimate inflationary effect of this faster rate of monetary expansion would be delayed. Its effects would not begin to be felt until next year. A year from now, however, the rate of inflation would begin to rise noticeably. At that time it would be too late to do anything about it, without severly restricting production and employment. The inflation process, once set in motion, is difficult to stop. The lesson of the past decade should have taught us that!

As has happened over the past 10 years, price increases develop a momentum and continue to rise at an accelerated pace, as long as the market detects that the ultimate source of inflation. . . excessive money growth. . . continues unabated.

So the question boils down to this. Do we pump in money now, knowing that in 1979 or 1980 we will have to face accelerated inflation? If we do, will we recognize in the future that the source of our worsening inflation was an accelerated pace of money growth which would have begun in 1977? It is more likely that the snapshots taken of the economy in 1979 and 1980 will reveal other convenient scapegoats, like wages, profits, interest rates or foreign influences. At that time the short-sighted view could be to resort to direct government controls, because the inflation "obviously" is out of hand.

Such policy would be "fly now, pay later" economics at its worst. What is really required is a reduction in the rate of monetary expansion. By the time that accelerating inflation becomes evident, it will be too late, for the inflation process will have become entrenched. Contracts, both formal and implicit, will have been rewritten and the inflation will have become increasingly institutionalized. Both long and short-term interest rates will be rising, as will wage demands. The entire initial effect of monetary restriction would have to fall on production. Unemployment will rise and we would be right back where we started.

The "fly now, pay later" approach is an important and useful device in the private economy. In the private sector there is a clear understanding that satisfaction of current desires requires some future sacrifice. For government, however, this is a very dangerous device. The day-to-day demands placed upon government make it particularly difficult to face up to the debts incurred yesterday. The tendency is to borrow further.

Individuals and business cannot afford to ignore the future consequences of their actions because they personally will be held accountable. The same is true of government, in principle. There is one major difference, however. . . the government can print money and thereby appear to avoid the accumulated debt. The cost is avoided only for a time, however. What is really happening is that we are taking out an ever-larger mortgage on the future standard of living of our Nation.

These are challenging times and the next few months are almost certain to bring forth some interesting economic proposals. We can expect proposals for stepped-up spending by government; there will be calls for monetary stimulus, and very possibly, the time-worn proposal for wages and price controls will be dusted off and placed before us again.

As citizens with a deep stake in the future of this Nation, it is important that we listen to all proposals and carefully consider all options. It is equally important that we not permit outselves to be panicked into hasty, ill-advised actions which would lead to a further erosion of free market economic forces which have served our society so well.

History is full of examples of nations that relinquished their freedoms on the false assumption that government can somehow accomplish goals that are unattainable through free markets and free institutions. I know it is sometimes tempting to listen to those who would have us believe that the American experiment is running out of steam and that it is our inevitable fate to follow in the footsteps of other great societies which lost their way and ultimately declined into oblivion.

I believe in the American system and I believe in the capacity of free individuals to manage their own destinies. If you share in these beliefs, and I know that you do, I urge you to speak out on these important issues and join with me in urging others to be willing to forego the apparent simple solutions of the moment for the long-terms benefit of future generations. By doing so, we will not only serve our own best interest, but we will assure a brighter future for our children and our children's children.