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THE FREE VS. THE MANIPULATED SOCIETY

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I am greatly honored to be asked to talk before the Economic Club of New York, which the late Wendell Willkie called "the foremost non-partisan forum of men in this country." It is well to remind ourselves of that saying tonight in the immediate aftermath of a presidential campaign which has not lacked what we may call partisan vigor. The votes are now counted, and along with all other Americans we salute the President. We may also, I think, salute his opponent, who, as with Willkie in 1940, failed of election and yet who, unless I am greatly mistaken, has helped to sharpen the political and economic dialogue for the years ahead.

Yet if the dialogue about the future of America is to continue successfully and in orderly fashion, the main burden will fall on non-partisan organizations like the Economic Club. We have heard that "Old soldiers never die. They just fade away." Might I suggest to you that great economic and political issues neither die nor fade away, even in an age of accelerated change. What kind of government we have in this country and what kind of an economy depends on continuing debate. As Lord Keynes once remarked: "Soon or late, it is ideas, not vested interests, which are dangerous for good or evil."

Among the fundamental ideas which have animated the American experiment is the concept of individual Liberty under Law, which I take to be the basis of our political and economic institutions. My purpose tonight is to explore how this American experiment in ordered freedom is faring, and if we look at the economy itself the evidence is encouraging. We are now in the fourth year of one of the longest economic expansions in our history. The national income, if you will permit me to use that old-fashioned phrase, is still on the way up, as is industrial production.

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Capital investment is running strong and, thanks to that investment and advancing technologies, average family income in the United States now runs to over $8,000 or double that of any other country. All over the western world, Capitalism, so often declared moribund, has exhibited new strength. Khrushchev who said he has yet now come to bury us has departed. The American experiment ~~goes~~ moves on.

Yet amidst all this good news there are also some aspects of our prosperity and affluence which are not so pleasing, and without trying to be a spoil sport tonight, I would draw these too to your attention:

1. In the first place, the present economic upsurge, like booms before it, has been feeding on what some feel is an excess of easy money as well as deficit finance.

2. In the second place, powerful pressure groups are now demanding more in the way of wages than some of us feel is good for the economy and all workers in it. I refer of course to the recent settlements of Chrysler, Ford and General Motors and the possibility of a large settlement to come in steel.

3. In the third place and looking to the longer future, I am concerned lest the Government, while creating inflationary pressures with one hand, will reach out with the other for more and more power to control the economy in areas where it has no business to trespass,and so bit by bit may weaken our economic system and the liberties which go with it.

It is my view that in the economic field Governments have two over-riding obligations. One is to help maintain a sound and dependable monetary system through which all transactions are made. The other is to help enforce the discipline of the market place against industry and labor alike. What we may be running into is a different situation where Governments, failing in their primary duties to provide sound money and to maintain open markets, seek to control and to manipulate specific prices, wages and foreign exchange dealings. This development, if and as it occurs, I submit can be as harmful to our institutions as the overt kind of socialisation of the means of production practiced in some other countries. The danger I suggest is not that of strong Government, which we need, nor of big Government, which we may have to have, but of manipulative Government, which instead of laying down the rules of the road will in fact try to drive the car along the road.

Good Government means good money

Let me begin with the problem of money because I take it to be an indubitable proposition that good money and good government go together. It is now a little over a decade ago that the founder of Time Inc., Henry R. Luce, stood ~~on the platform~~ before you and in a notable address titled Freedom and Order emphasized that the maintenance of a sound dollar was the first order of American business. To a degree we have ben fulfilling that mission even though the American dollar is not quite what it used to be. I hold in my hand a Federal Reserve note which in bygone days used to promise that it would pay the bearer a fixed quantity of gold. Those days are of course long past and today a paper federal reserve note at best promises the bearer to pay him another piece of paper should he be so bold as to present it at the counter for redemption.

But let us pass that. The worth of a currency we have come to believe is not how much its weight is in gold but what it will buy and here the record at least is fairly reassuring. The dollar is worth about 50% of what it was before World War Two, but in recent years its purchasing power, as measured at least in domestic wholesale prices, has remained relatively steady. Nevertheless, the cost of living in this country continues to edge up by 1% to 1 1/2% per year and that is more than it appears on the surface. Indeed an inflation of 2% per year compounded means that a long term Government security bought in good faith by an American today will have its value halved in ~~less than~~ a generation. And it is estimated that between 1960 and 63 some 33% of the gain made in our National Product was spurious, resulting from an increase in prices rather than an increase in output.

Moreover we must look in these matters a bit below the surface. In the above years there has been an immense increase both in bank credit and the money supply. Commercial bank credit (loans and investments) went up by $51 billions, and total money supply, counting currency, demand and commercial bank time deposits rose by no less than 24 per cent or an average of 8 per cent per year. Between the first half of May of this year and August, currency and demand deposits alone rose by 7 per cent or far more than normal. There are now indications that the Federal Reserve is now putting a tighter leash on credit, but we have already gone pretty far in monetary expansion and in creating domestic liquidity. Indeed, a banker friend of mine remarked the other day: "We have reached a position where almost any damn fool can finance any damn venture he chooses." I am not a monetary expert but the thought does occur to me that in achieving prosperity now we have been burning up an awful lot of monetary ammunition which might have been better reserved for recession contingencies. As the old British saying goes: "If it is this way in the green wood, what will it be in the dry?"

Tax Reform vs. Deficits

Precisely the same question must occur to some of us with respect to fiscal policy. The present boom has been fed by a great increase in federal spending which rose from $81 billion in fiscal 1961 to $97 billion in fiscal 1965 with constant federal deficits. The government has been cutting back on military outlays, but non-defense expenditures continue to gain, and new programs are on the way. In the past several months there has been continuous pressure for more spending for housing, for the anti-poverty campaign, as well as the proposal for greatly enlarging our social security system through Medicare.

But already in 1964 the burden of spending was onerous. If we count the outlays of the social security trust funds and other outlets, total cash spending by the federal government amounted to $122 billion, with another $70 billions of state and local spending pile on top of that. This $190 billion is nearly a third of national product. All this must be paid for in one way or another - by taxes, by borrowing or by inflation. In 1964 total taxes in the U.S.-federal, state and local - ran to $160 billion, or $2, 800 per household and $840 per capita!

Now Washington promises to ease this burden by further tax cuts and this is pleasant talk indeed. But how much further can tax cutting go unless expenditures are brought under control and reduced? Do we really want to accept perpetual federal deficits as a way of life? Some people, of course, do. They believe the deficits are good for the economy. But this I suggest is just old-fashioned depression reasoning turned on its head. The true promise of tax revision is to get the steep progression out of the income tax and to reduce, if we can, the corporation tax which is a best an indirect tax.

This may sometimes imply temporary deficits but surely not all of the time. Indeed it seems to me that in good times the federal government should be running a surplus, allowing deficits to occur in recession when tax receipts fall off. We seem to be traveling a long way from this kind of prudent compensatory fiscal policy; and if we are not careful tax cutting will just become another political gimmick for attracting votes while meanwhile harming the economy.

The Secret of Wages

So if we look at the economy from the point of view of money and fiscal policy there is some reason for concern. We come now to the second phenomenon which I mentioned earlier which tends to increase this unease, - namely that wage rates after a period of relative quiexcence have begun to move up sharply. In the sixties wage advance in manufacturing at least advanced no faster than overall gains in productivity. The Ford and Chrysler settlements broke through this pattern with wage and fringe benefits going up by well over 4%. Big companies can for a while no doubt "absorb" such increases. But as these pressures spread, as they are likely to spread, we are bound to face trouble.

It is very important that we correctly analyze the nature of this trouble. On the popular view excessive wage advances are the direct cause of inflation. This is to oversimplify matters. What happens is that when wages are artifically pressed upward producers, and especially marginal producers, will find their profit margins are squeezed unless they also raise prices. This puts the monetary and fiscal authorities on the horns of a dilemma. If they continue to make money easy so that prices can rise - if they "validate" the new wage advance - then we find ourselves on the familiar cost-price spiral. If on the other hand the authorities try to tighten up on credit and prevent prices from rising, they risk killing off the goose that laid the golden egg - and indeed laying an egg themselves.

The fundamental proposition that needs stressing is that wages and salaries which constitute the income of most of our society have a double aspect. They are purchasing power to the recipient, but they are also costs to the firm that pays the bill. In a dynamic economy with technology rapidly advancing we, of course, expect and get a rise in wages over the long term either in the form of increased money wage rates or in the form of lower prices. And it is the glory of the American economy that over the years real wages have tended to move upward and began to do so long before the arrival of powerful unions.

But the evidence is just as clear that where wages are wrenched upward on the short term by union pressures or government edict they will have a powerful "unemployment effect" on the economy unless prices are also raised. This is one of the best kept secrets in official Washington and in trade union circles, but it is also one of the most firmly grounded truths in all of economics. Wages and salaries, after all, are a form of price, - the price of human effort and talent. Push this price high and you are bound to get unemployed resources.

Some Formidable Witnesses

This is just plain common sense which all recognize in our day to day dealings. It is also backed by formidable economic opinion. I could quote here a long list of eminent witnesses who are quite clear on the point that if wages are pushed forward too rapidly they will tend to create unemployment - the late Sumner Slichter, the late Lord Beveridge, and Senator Paul A. Douglas of Illinois who before he became a politician wrote a famous and definitive book on Wages. But the most interesting and surprising witness I believe is the late Lord Keynes who it was my privilege to know during the war years and who exercised such enormous influence on a whole generation of economists.

Lord Keynes is the father of modern spending theory and is often misquoted as saying that wage increases must be good because they will generate purchasing power. Those who interpret him that way have presumably not read his master works. At the very beginning of his most famous text, The General Theory of Employment, Interest and Money, Keynes states that he has no quarrel with the so-called "classical" doctrine that if wages are pushed above marginal product unemployment will result, and his whole theory of overcoming recessions and depressions takes this into account. Briefly Keynes believed that recessions involve a fall in prices which in turn damages profit and investment expectations. In these circumstances he was against general wage cutting and favored government efforts to "reflate" the economy by easing credit and by spending. But the whole point of this remedy was to raise prices faster than wage rates and to temporarily reduce real wages. But if wages rise with prices then the whole attempt at reflation will be aborted, and in fact something like this seems to have happened during the great depression. In that period the government did gingerly try out deficit spending but was never able to restore full employment until the coming World War II saved the New Deal. And one reason for this failure involves another well guarded secret: between 1931 and 1940 money wages in the U.S. rose by no less than 48% and real wages by 44%.

But we need not go back into the distant past to know that artificial wage increases are destructive and indeed inhumane. The widespread distress and unemployment in the coal industry goes back in part in my judgment to the huge bidding up of wage rates in the immediate period after World War II. The present distress and unemployment among our unskilled workers and Negroes is in part attributable to ill-advised government attempts to boost minimum wage laws. And in terms of the business cycle the evidence is overwhelming that excessive wage advances are disruptive. Such advances killed off the boom of 1956-57 leading on the the recession of 57-58. That recession in my judgment was prolonged by the stubborn tendency of wages to move upward in the face of very considerable unemployment. Now in the fourth year of a long advance we face the same old dilemma: if wages move up at anything like the pace of the Chrysler-Ford settlements they will create unemployment unless prices are also raised. To counter this unemployment effect the government will be tempted to let prices go up by injecting still more credit into the system or by deficit spending or tax cutting. Then comes a still ominous development: - the demand that the government "do something" about the situation by instituting some kind of direct controls over prices, wages and profits, thereby fatally damaging the whole free market process.

Needed: some new "Guide Lines"

I cannot believe, gentlemen, that this is the way out for the American economy but I would be remiss if I did not indicate that the danger of controls is more than a distant cloud on the horizon. No one, of course, favors outright and open controls such as we had in wartime, but the itch for more subtle controls is quite apparent in Washington. In the matter of steel prices the President let it be known some months ago that he would regard any rise in steel prices as against the "national interest". I would submit that if a President can invoke the national interest in steel he is logically in a position to dictate almost any price in the economy!

In the matter of wages the government has been placing great faith in its so-called "guide-post" theory under which all is supposed to be well if overall wages in the economy rise no faster than overall productivity - perhaps at 3% per year. I must confess I have little faith in this approach if only because Mr. Reuther has quite obviously turned his back on the guide-posts with impunity. The fact is that if the guide-posts are to be anything more than talk they imply precisely the kind of government dictation of wages and prices which it should be our business to avoid. In this matter I would commend your attention to the current Morgan Guaranty Letter which makes the most trenchant analysis of the guide-posts which has come to my hand. As the Letter points out the guide-post theory at best is supposed to give us a picture of what price and wage behavior <u>would be</u> in a truly competitive economy. <u>Very well.</u> But if our objective is to get those conditions why risk controls to obtain them? Why not move openly and honestly to restore competitive conditions in the labor market as well as in the product market?

And this, gentlemen, is precisely the kind of reform which I do favor, and it involves no dangerous and no unconstitutional enlargement of government authority. In the case of industry we have the anti-trust laws to enforce price competition, and if the president is worried about the price of steel his appeal should be to those laws. In the case of organized labor we lack any such constitutional means for enforcing the market discipline. On the contrary the government has granted to unions a whole series of exemptions from laws governing most other forms of free associations which are far-reaching, and which make unions unique organizations in our economy. I believe that sooner or later we must come to grips with this union monopoly power, not by putting new laws on the books, but by withdrawing special privileges which unions now enjoy.

The elaboration of this thesis might carry us far and indeed too far into the intricacies of labor laws. But while we are speaking of guide-posts, let me suggest a few which have a bearing on our troubles. In the first place, I believe that unions should be what they originally started out to be - namely, purely voluntary organizations. There should be no place in America for the closed shop, the union shop or any other kind of shop which makes payment of union dues the price of a job. In the second place, I believe that we should insist on "freedom of entry" into all trades and professions: restrictions of the kind exercised in the building trades should be illegal. In the third place, I think we must distinguish sharply between the right of men to strike or to lay down their tools and their alleged right - which is no right at all - to prevent others from working.

In the election just passed we heard a great deal about violence in the streets. May I suggest that some of that violence traces back to union violence overtly manifest in almost every waterfront of the land. We should aim to reduce, in short, <u>coercion</u> of all kinds. This is only partly a responsibility of the federal authorities. It is also the responsibility of state and local authorities for enforcing laws, now on the books, but which are continuously honored in the breach.

The method of carrying through the principles outlined above will bear a lot of non-partisan discussion. It well may be that we shall have to come in the end to trying to apply the anti-trust laws to union organization. But if we do let us be clear on objectives. The objective is not to smash union organizations. It is not to deny men the right of free association. It is rather to reduce momopoly power and to allow unions to play the part, which I am confident they have to play in the world of tomorrow, as free collective bargaining agencies. But let our emphasis be on the free not just on the collective, else I believe we run some danger of subtly collectivizing American society.

"What's Good for America"

In short and to repeat, I am for enforcing not only the monetary discipline but also the market discipline. Needed at home I believe this is also needed if the U.S. is to play its full part in the wider world in encouraging freedom of trade, freedom of investment, and freedom of men and women to move across national borders. On that effort a lot is riding tonight. Let me conclude my remarks by looking outward to this wider world of which the U. S. is a part. For here, too, we shall find we face decisive choice between the free and the manipulated economy.

As you know, the U. S. for nearly a decade now has been failing to balance its accounts with the outside world and until very recently at least has been subjected to large losses of its ultimate gold reserves. There are many special reasons for this situation including our large outpayments of foreign aid, which I believe need to be cut, and our large payments for maintaining American military personnel overseas, which are being reduced but which are nonetheless essential for the defence of our vital interests. But over the long run and despite these special circumstances, I believe the U. S. should be able to cover its outpayments to foreign nations with inpayments or earnings, and the traditional means for righting balance of payments difficulties are well known. They would consist in balancing our domestic budget, tightening credit here with an accompanying rise in interest rates, and finally restraining costs so as to make our goods more competitive.

Unhappily, these time-tested remedies for balancing our accounts overseas have been applied at best gingerly and there has been, it seems to me, a lamentable tendency to try to "paper over our difficulties." Some of the technical measures adopted are relatively harmless, consisting simply in better coordination and collaboration between the world's central banks. But at lease one measure seems to me to be definitely dangerous. I refer, of course, to the recent passage of the so-called Interest Equalization Tax, which penalizes Americans who buy foreign securities and so tries to staunch the outflow of private U. S. capital to foreign lands. In the first place, the tax, having been passed, is likely to prove ineffective. In the second place, it is highly discriminatory and arbitrary in all of its aspects. In the third place, it comes dangerously close to imposing outright exchange controls on the American dollar, the world's key currency.

I should not have to remind you of the dangers of such controls. On the record in Europe exchange controls abroad have always been the entering wedge for specific wage controls at home. They are the means by which dictatorships, whether of left or right persuasion, have tried to impose their wills on foreign countries - let us remember the manipulations of the late Dr. Haljmar Schacht during the Hitler regime!! We have not gone that far and there is no inevitable need for our going that far, but the dangers are real. If we have more inflation in this country, then progress made in getting our foreign accounts into balance will evaporate. If unhappily we stumble into recession, then our budget, still in deficit, is likely to swing further into the red, and we shall want in our own interest to ease money rates. In this case, we might well see a run on the dollar and to prevent that run we may be sure there will be more proposals for turning potential exchange controls into real exchange controls.

The time to prepare for and to prevent these contingencies from happening is now, and I would submit that some of the measures I have argued for in promiting a healthier and stronger domestic economy would also help us in resolving our difficulties on the international front. Today we are torn between two different objectives - the objective of maintaining high employment levels at home, and the objective of maintaining a strong dollar abroad. My thesis is that if we restored competition and flexibility into our labor market, we shall have less need for constant monetary and fiscal stimulants which in fact tend to undermine the dollar's worth. It is all too common today to compartmentalize our problems.\ In the last analysis, such compartmentalization is impossible. The market economy needs sound money. But sound money likewise entails the maintenance of the market discipline. And if we can maintain sound money and open markets in the U. S., we shall be that much more able to contribute to a decent international order. To paraphrase the late Charles Wilson: "What is good for the U. S. is also good for the rest of the world - and vice versa."

So, to conclude, I would say, be of good cheer. There are no limits to the development of this country and to the role which it can play on the seven seas and beyond the seven seas. But if we are to live up to this role, we must stand up for certain fundamentals: for the enlargement, not the constriction, of individual liberty under law; for strong government but a government also of limited and delegated powers; for a business enterprise system which by dispersing economic decisions and power complements and supports our unique political inheritance. In this system you businessmen are the indispensable players of the game. You also are the co-guardians with all other Americans of the rules, which allow the game to be played. In guarding the title deeds of freedom, let us not be doctrinaire. Let us also keep in mind some advice of Tom Paine who said, "A thing moderately good is not so good as it ought to be. Moderation in temper is always a virtue. Moderation in principle is always vice."

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