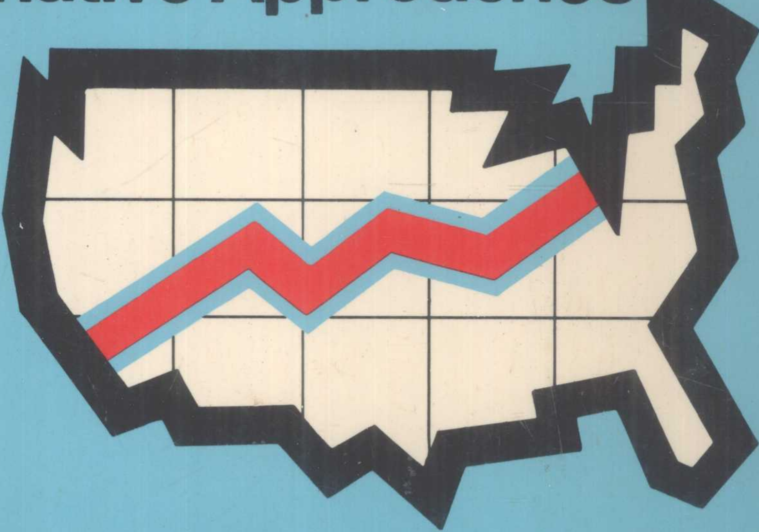
MACRO-ECONOMIC ISSUES TODAY

Alternative Approaches



ROBERT B. CARSON

MACROECONOMIC ISSUES TODAY

Alternative Approaches

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To Jim and Sarah, who will soon have to make their own hard choices . . . and act on them

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Preface

The publication of *Macroeconomic Issues Today: Alternative Approaches* is occasioned by the response to an earlier volume entitled *Economic Issues Today: Alternative Approaches* (St. Martin's, 1978). The earlier book, which examines both macroeconomic and microeconomic issues, has been adopted in hundreds of courses in principles of economics or economic issues, as well as some intermediate courses, and it will continue to be available for instructors preferring a compact single volume. Many instructors, however, have suggested that they would welcome the flexibility afforded by separate volumes dealing with macro and micro concerns.

Macroeconomic Issues Today incorporates four issues from the original book and four new ones. A companion volume, *Microeconomic Issues Today*, incorporates eight of the twelve issues presented in the original book. The discussions in both volumes have been revised wherever changes seemed warranted by events since the first publication in 1978. An Instructor's Manual is available for each volume.

Let me explain why I undertook this project in the first place. All too frequently, students begin their study of economics with the impression that economists as a group are bland, dull, and monolithic in the discussion of important issues confronting the general society. We may as well admit that the profession sometimes exhibits a tendency to be rather bland in its public utterances, but surely any supposed unanimity toward social policy questions has vanished. With the rise of a large radical caucus within the discipline, beginning in the late 1960s, and the recent resurgence of variations of laissez-faire ideology, the facade of consensus has clearly been broken down. The application of economic theory to issues of public policy more and more reflects a range of choice from Conservative, to Liberal, to Radical on the political spectrum.

For the student struggling with basic theory and analytic tools, as well as for the ordinary citizen overwhelmed by economic data in the newspapers and on the TV evening news, it is hard to avoid confusion about what economists really think about the problems facing the nation. This book begins with the assumption that the answers economists give to policy questions can usefully be compared and analyzed according to the particular biases of their arguments and the probable outcomes of their proposals. In other words, differences in economic logic and interpretation of evidence are not so much a function of skill mastery as they are the expression of strongly held social and political opinions. The book also assumes that economics as a body of knowledge takes on greater meaning and is more readily comprehended when it is viewed in this way.

Readers should understand that this is a very "arbitrary" kind of book. Its arbitrariness, however, is not one-sided. On each issue, Conservative, Liberal, and Radical analyses and proposals are presented independently and in a first-person advocacy manner. On one page, there may be a vigorous and unyielding defense of laissez faire and the market economy; on another, a program for the elimination or modification of the free market. This is not the way economic analysis and theory is usually taught, but it is what the practice of economics is about. In the real world, the citizen and the economist make public policy choices that protect, attack, or modify the market mechanism. We may defend our positions in terms of economic logic, but behind our proofs lies our political and ideological view of the world. This book attempts to examine the relationship between ideological values and the economic theories and policies that are their outcome.

Since the book presents a wide range of views on a number of currently sensitive issues, it should provoke disagreement, controversy, and discussion. In itself, the book does not urge a particular ideological position or a particular variety of economic analysis. The decision to select or reject this or that point of view is left, as it should be, to the reader.

While I was writing, a curious colleague asked me to explain what exactly I was trying to do. I obliged him as best I could, and he observed, "If you're really successful, you'll have written a book that will be at least two-thirds objectionable to every reader." Although I hadn't thought of it that way before, I suppose that is precisely the goal—to constructively anger a reader two-thirds of the time.

The arguments are presented in plain language, with as little use of economic jargon as possible. The chapters are self-contained and may be assigned in any order the instructor chooses. (The Instructor's Manual provides a grid correlating the chapters here with the chapters in the leading principles textbooks.) There are relatively few footnotes or direct references to particular economists, although the ideas of many contemporary economists and schools of economic thought will be apparent. The bibliography at the end is offered for anyone wishing to dig a little deeper into an issue or a particular economic perspective or approach.

The decision to minimize the explicit discussion of technical terms and specific economic concepts in the discussion of contemporary policy issues does not mean the author rejects the importance of formal economic analysis. For instructors using *Macroeconomic Issues Today* along with a conventional principles of economics textbook, the formal analysis will be supplied by the principles text and classroom instruction. For instructors using the book without a conventional text, the Instructor's Manual supplies an outline of the pertinent economic concepts and provides graphical analyses. Even instructors using this book as a collateral reading may find the manual quite useful.

The basic outline of this book grew out of discussions with Irving Rockwood and my own earlier experience with two collections of readings in economics. As the work developed, I received further encouragement in very early stages from Tony Dick and Murray Curtin, and at a later, and most critical juncture, from Bertrand Lummus of St. Martin's Press. Indeed, Bert Lummus' steady encouragement in the writing and final preparation of the manuscript was crucial. No author could wish for a more stimulating and congenially demanding editor. The editorial and production work of the St. Martin's staff, especially the help given by Emily Berleth, deserves special recognition.

A fair number of colleagues have made important contributions. Some offered explicit suggestions for changes in style and content. Others' contributions were less direct and perhaps not even known at the time. Their help came from their critical skills and their ordinary activities as teachers, scholars, and friends. Without differentiating the particular contributions, I would like especially to thank George Webster and David Ring of Hartwick College, Natalie Marshall of Vassar College, and Alfred Lubell, Daniel Fine, Guy C.Z. Mhone, and Robert Moynihan of State University College at Oneonta, New York. Kevin O'Donnell and Harold Dodt served courageously and well as research assistants.

For typing, research, important "go-for" work, and other support in preparing the manuscript, I am indebted to Ruth Wheeler, Barbara Lifgren, Sheila Reynolds, Sue Lapine, Michael McKeon, Diane Collin, Riva Daniels, Joann Gorko, Peter Granger, Brian Schmid, and, of course, my wife, Marjorie Gale Carson. A special debt is owed Charlize Fazio for typing from my impossible scrawl and meeting equally impossible deadlines. My son, James, and my daughter, Sarah, were also helpful as they cheerfully adapted to their father's preoccupation with writing.

Finally, but most importantly, a book of this kind comes out of classroom experiences and learning from the students themselves. Students are always the instructor's and author's best teachers and critics. During a decade and a half of teaching, I have incurred too many debts of this kind to begin to list names. However, without the thoughtful and demanding ideas and skepticism of hundreds "on the other side of the desk," I would not have been prepared to undertake this effort.

Of course, the aid given by all those named above by no means shifts responsibility or implies their agreement with all or any of the finished manuscript.

Robert B. Carson

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PART 1

INTRODUCTION

Alternative Economic Philosophies

A Survey of Conservative, Liberal, and Radical Critiques

> The ideas of economists, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.
>
> *John Maynard Keynes, 1936*

The Ideological Basis of Economics

"More government spending for jobs!" "Less spending to halt inflation!" "More overseas business expansion to help profits!" "Stop American imperialism!" "End government meddling with business!" "Make the corporations pay for their damage to the environment!" All around us we hear the steady clatter of noisy political recipes offering solutions to the economic problems haunting the United States. The competing arguments and policy proposals coming from political parties, public figures, and the news media seem endless. Ordinary citizens are quite understandably confused as to what course of public policy to support.

No wonder that practically every economist has been asked by at least one earnest relative, friend, student, businessperson, or labor leader "what *the economists* think and recommend" on a particular issue. Such a question usually reflects a certain naiveté on the questioner's part about what economists as a group really think and do. Most people—including beginning economics students—have a tendency to assume that economists somehow agree. After all, it would seem logical that a man or woman whose professional interest is, say, studying the problem of unemployment should be able to tell exactly how the unemployment problem can be solved. Once upon a time, economists would shrink from such a question by pointing out that they only studied unemployment; solving it was a political problem. Over the past several decades, though, economics and economists have moved far beyond classroom teaching and debate. No longer do they occasionally consult with presidents, business executives, and labor leaders; now they advise them. However, the advice given on any particular problem varies among economists. This is often quite a surprise to the citizen questioner who, although paying due professional respect to the economists, still sees him or her as a kind of mechanic. When one's car does not start, the car owner expects (at least hopes) that the diagnosis of mechanical trouble given at one garage is exactly the same as what he will hear at any other. If there is one mechanical problem, there should be one mechanical solution. The moral of this comparison is that economics is more than studying a repair manual and economists are not mechanics.

Once, an exasperated President Kennedy, trying hard to find a politically acceptable route out of a national recession, exclaimed, "If you laid all economists head to feet, all you would reach is confusion." The president missed the point. Really what you would reach wouldn't be confusion but different points of view. While practitioners of conventional economics rarely like to admit their differences, the facts of disagreement override professional courtesy. The economist who urges tight money to stop inflation as a requirement for dealing with unemployment is miles apart from a colleague who advocates a massive public works program to reduce unemployment.

How is such disagreement possible? Isn't economics a science? Economists' answers to that question vary. A common and reasonable enough response is simply that scientists disagree, too. While there is much truth to such an answer, it really begs the question. Plainly, the "dismal science" of economics is not a science like physics. While economists may sometimes talk about the laws of supply and demand as if they were eternal verities like the law of gravity, there is abundant anthropological and historical evidence that many societies have behaved quite contrary to the laws of supply and demand. Outside of science fiction, however, there is no denying the law of gravity.

To be sure, economists employ (or at least they should) the rigor of scientific method and quantitative techniques in collecting data, testing hypotheses, and offering reasonable conclusions and predictions. However, economists deal with different "stuff" from that of their colleagues in the exact sciences. Their data involve human beings and their laboratory is a world of behavior and perception that varies with time and place. On top of this, economists, like all social scientists, are called upon to answer a question not asked of those in the "pure" sciences: "What *ought* to be?" Astronomers, for instance, are not asked what *ought* to be the gravitational relationships of our universe. That would be a nonsense question. Economists, however, cannot evade making some determinations about optimal prices, optimal income distribution, and so forth. Their decisions, while perhaps based upon a genuine effort at neutrality, detachment, and honest evaluation of the available evidence, must finally be a matter of interpretation, a value judgment based upon their own particular world views. To put the point directly: Economics, as a study of human behavior, cannot avoid value judgments. Struggle as it may, economics as a discipline is never free from ideology.

Until recent years, most economists haven't talked much about ideology, or their individual political views of the world. "Ideology" has been somehow a dirty word, or unprofessional, or it has been too troublesome to deal with. But, as the pressure of crises within the economy and society heightened in the 1960s and 1970s, the economics profession more and more found itself shifting from debate over merely "theoretical" questions to those centering on concrete political issues. The *Newsweek* editorials of the Conservative Milton Friedman and the Liberal Paul Samuelson show that leaders of the profession now fearlessly parade their politics as they offer their particular analyses of economic problems. Meanwhile, the shrill debate between conventional economists and those of a more radical persuasion has forced increased attention to political economic alternatives.

The significance of these trends should not be lost on the beginning student of economics. The above arguments hold that the content and application of economic reasoning are finally determined by the force of what people believe, not by an independent and neutral logic. But to say that economics is a matter of opinion is not to say that it is just a study of relatively different ideas: Here's this view and here's that one and each is of equal value. In fact, opinions are not of equal value. There are good opinions and there are bad ones. Economic ideas have different consequences when adopted as policy. They have different effects, now and in the future. As we confront the various policy solutions proposed to deal with the many crises now gnawing deep into our economy and society, we must make choices. This one seems likely to produce desired outcomes. That one does not. No other situation is consistent with a free and reasoned society. Granted it is a painful situation, since choice always raises doubts and uncertainty and runs the risk of wrong judgment, but it cannot be evaded.

This short book is intended to focus on a limited number of the hard choices that we must make. Its basic premise is that economic judgment is basically a matter of learning to choose the best policy solution among all possible solutions. This book further assumes that failure to make this choice is to underestimate the richness and importance of the economic ideas we learn and to be blind to the fact that ideas and analysis do indeed apply to the real world of our own lives.

On Sorting Out Ideologies

Assuming we have been at least partially convincing in our argument that economic analysis is permeated by ideological judgment, we now turn to examine the varieties of ideology common to American economic thought.

In general, we may characterize the ideological position of contemporary economics and economists as Conservative, Liberal, or Radical. These, the same handy categories that evening newscasters use to describe political positions, presumably have some meaning to people. The trouble with labels, though, is that they can mean a great deal and, at the same time, nothing at all. At a distance the various political colors of Conservative, Liberal, and Radical banners are vividly different. Close up, though, the distinctiveness blurs, and what seemed obvious differences are not so clear. For instance, there is probably *not* a strictly Liberal position on every economic issue, nor are all the economists who might be generally termed "Liberal" in consistent agreement. The same is true in the case of many Radical or Conservative positions as well. Unless we maintain a certain open-endedness in our categorizing of positions, the discussion of ideological differences will be overly simple and much too rigid. Therefore, the following generalizations and applications of ideological typologies will attempt to isolate and identify only "representative" positions. By doing this we can at least focus on the differences at the center rather than on the fuzziness at the fringes of schools of thought.

We are still left with a problem. How do you specify an ideological position? Can you define a Radical or a Liberal or a Conservative position? The answer here is simple enough. As the British economist Joan Robinson once observed, an ideology is like an elephant—you can't define an elephant but you should know one when you see it. Moreover, you should know the difference between an elephant and a horse or a cow without having to resort to definitions.

There is a general framework of thought within each of the three ideological schools by which we can recognize them. Thus we will not "define" the schools but merely describe the salient characteristics of each. In all the following, the reader is urged to remember that there are many varieties of elephants. Our specification of a particular ideological view on any issue is a representative model—a kind of average-looking elephant (or horse or cow). Thus, the Conservative view offered on the problem of inflation, for instance, should not be thought of as the only possible expression of Conservative thought on this question. However, it should be sufficiently representative so that the basic Conservative paradigm, or world view, can be distinguished from the Radical or Liberal argument.

THE CONSERVATIVE PARADIGM

What is usually labeled the Conservative position in economic thought and policy making was not always "Conservative." Conservative ideas may be traced to quite radical origins. The forebears of modern Conservative thought—among them England's Adam Smith (1723–1790)—were not interested in "conserving" the economic order they knew but in destroying it. In 1776, when Smith wrote his classic *Wealth of Nations*, England was organized under a more or less closed economic system of monopoly rights, trade restriction, and constant government interference with the marketplace and with an individual's business and private affairs. This system, known as mercantilism, had been dominant in England, and, with slight variations, elsewhere on the Continent, for over 250 years.

Smith's remedy was simple enough: Remove all restrictions on commercial and industrial activity and allow the market to work freely. The philosophical basis of Smith's argument rested on his beliefs that (1) all men had the natural right to obtain and protect their property; (2) all men were by nature materialistic; and (3) all men were rational and would, by their own reason, seek to maximize their material well-being. These individualistic tendencies in men would be tempered by competition in the marketplace. There men would have to compromise with one another to gain any individual satisfaction whatsoever. The overall effect of these compromises would ultimately lead to national as well as individual satisfaction. Competition and self-interest would keep prices down and production high and rising. They would also stimulate product improvement, invention, and steady economic progress. For this to happen, of course, there would have to be a minimum of interference with the free market—no big government, no powerful unions, and no conspiring in trade. Smith's position and that of his contemporaries and followers was known as "Classical Liberalism." The Conservative label now applied to these views seems to have been affixed much later, when Smith's heirs found themselves acting in the defense of a status quo rather than opposing an older order.

Thus, modern capitalist economic thought must trace its origins to Adam Smith. While this body of thought has been built upon and modified over the past 200 years, the hand of Adam Smith is evident