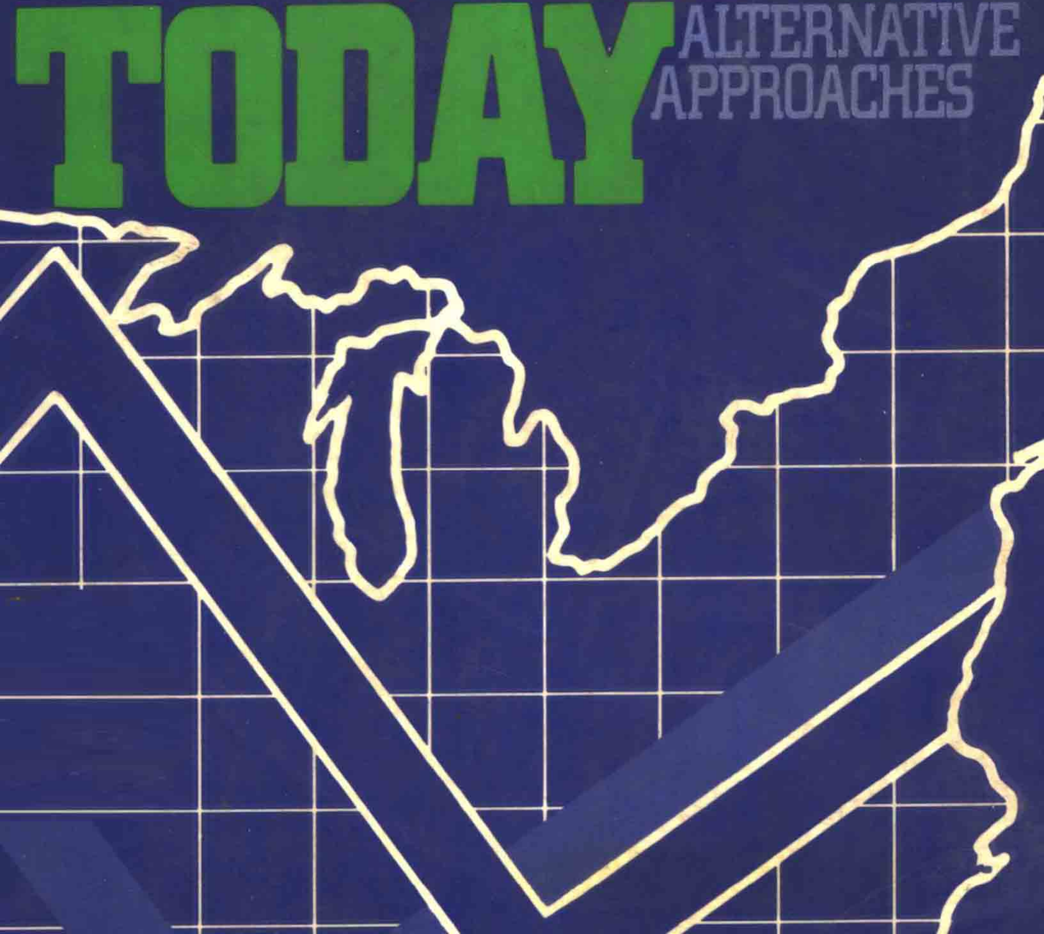
FOURTH EDITION

MACROECONOMIC ISSUES TODAY

ROBERT B. CARSON

ALTERNATIVE APPROACHES



MACROECONOMIC ISSUES TODAY

Alternative Approaches

Fourth Edition

Robert B. Carson

St. Martin's Press
New York

This book is dedicated to my mother,
Catherine Postlewaite Carson

Library of Congress Catalog Card Number: 86-60649

10987
fedcba
For information, write St. Martin's Press, Inc.
175 Fifth Avenue, New York, N.Y. 10010

cover design: Ben Santora

ISBN: 0-312-50340-7

ACKNOWLEDGMENTS

From E.Y. Harburg and Jay Gorney, "Brother Can You Spare a Dime?" Lyrics by E.Y. Harburg. Music by Jay Gorney. © 1932 by Warner Bros., Inc. Copyright renewed. All rights reserved. Used by permission.

Fig. 6-1 from Michael I. Boskin, ed., *The Crisis in Social Security.* San Francisco: Institute for Contemporary Studies, 1977, p. 8. Reprinted by permission.

Preface

Since the first appearance of *Macroeconomic Issues Today*, and its companion volume, *Microeconomic Issues Today*, in 1980, the author has tried to select topical issues that get to the heart of varieties of economic reasoning and deal with interesting and current economic problems. This, the fourth edition, is no exception. Instructors who have used earlier versions will note very considerable changes in the updating of the book; little in economics has stood still over the past ten years. I have benefited in this as in past revision efforts from correspondence from dozens of instructors and students who have taken time to suggest changes or simply comment on the book's content.

Among the changes longtime users of the book will notice are (1) a strengthening of the presentation of both the Conservative and Radical paradigms in the introduction and a certain "modernizing" of the Radical argument throughout the text, (2) a stronger and more up-to-date debate on fiscal policy alternatives, (3) a new issue on government deficits, and (4) a virtual rewriting of the old international trade issue to face the new trade and finance realities of the late 1980s. Of course, throughout the book I have inserted the most recent available references and data and added new tables and figures so that all the information is as fresh as it can possibly be. All in all, *Macroeconomic Issues Today* has undergone in this revision the most extensive rewriting and reorganizing since its original publication.

All these changes are designed to enhance, not alter, the pedagogical approach followed in earlier editions. As before, the book requires no background in the methods of economic analysis, and as much as possible it avoids the use of economic jargon in favor of everyday language. This edition of *Macroeconomic Issues Today*, like earlier ones, stresses the ideological choices that exist in economic thought and that often cause ordinary citizens to be confused about what economists *do* and what economists *believe*. As ever, it is meant to be a provocative book, more interested in provoking discussion and thought than in presenting "right" solutions to problems. It remains committed to the belief that real economic solutions are possible in a democratic society only when all alternatives are known and considered.

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 are bland and monolithic when discussing important issues confronting the general society. We may as well admit that the profession sometimes exhibits a tendency to blandness in its public utterances, but surely any supposed unanimity toward social policy questions has vanished. With the rise of an influential radical caucus within the discipline, beginning in the late 1960s, and the more recent resurgence of variations of laissez-faire ideology, any 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.

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 over 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 be usefully 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.

For each issue, a Conservative, Liberal, and Radical analysis and proposed solution are presented in turn as the valid approach to the problem. 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 are 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.

Each chapter is 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 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 text, the Instructor's Manual supplies an outline of the pertinent economic concepts. Even instructors using this book as 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 editing 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.

The publication of this new edition has incurred its own special debts, which deserve acknowledgment. Larry Swanson of St. Martin's Press took over the editorial responsibilities for this version and was a steady and encouraging influence in developing a revised and fresh edition. Emily Berleth again served brilliantly as project editor. Professor Jack Adams of the University of Arkansas at Little Rock, Professor James Hanson of Willamette University, and Edward

Salmonsen of Monterey Peninsula College read the manuscript and made many useful suggestions. Denise M. Sheehan of the State University of New York at Albany aided in preparing the Instructor's Manual. And, as always, there were the inspiration and encouragement given by my students, questioning and demanding answers to the "great" economic problems of the day regardless of whether the author had any notion of what the "answer" might be.

Contents

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

pressed through the Reagan victory, most Liberal "interventionists" are frankly confused. Many can be counted upon to hold on to their old commitment to pragmatic tinkering, especially those whose interests are closely and narrowly tied to special-interest groups—environmentalists, consumer advocates, the poor, minorities, labor unions, and so forth. Even a few business persons, worried about growing foreign competition and concerned about the decline of many of the nation's basic industries, have called for expanded government intervention. Others are beginning to rethink their position on intervention. To this group, it is not a question of abandoning the basic concept of government intervention in the economy—that would be an admission that the Conservatives' view of a self-balancing economy was essentially correct. Rather, the problem is to redefine what kind of intervention is desirable.

More and more, Liberals admit the failure of past interventionist programs: social assistance, the use of regulatory agencies, corporate and personal income tax policies, and many more of the centerpieces of Liberal economic legislation. Many have backed off from their earlier tendency to slap a government bandaid onto any and every economic problem. Others argue simply that the problem is only to find better solutions, not to stop undertaking the problems.

The present-day ambivalence of Liberals on the degree and type of intervention will be evident in our survey of economic issues in this book; nevertheless, this tendency should not be misunderstood. Specific Liberal approaches to problem solving may be debatable, but the essence of Liberal economics remains unchanged: The capitalist economy simply requires pragmatic adjustment from time to time to maintain overall balance and to protect particular elements in the society.

THE RADICAL PARADIGM

Specifying a Radical position would have been no problem a few decades ago. Outside of a handful of Marxist scholars, some socialists left over from the 1920s and 1930s, and a few unconventional muckrakers, there was no functioning Radical tradition in American economic thought. However, the two-sided struggles of the 1960s over racism and poverty at home and the war in Vietnam produced a resurgence of Radical critiques. By the mid 1970s, the Radical caucus within the American Economic Association had forced on that body topics for discussion at annual meetings that directly challenged conventional economic thought. The Union of Radical Political Economics (URPE) could boast over 2,000 members and its own journal. Meanwhile, basic textbooks in economics began to add chapters on "Radical economics."

The Marxist Heritage Radical economics had arrived—but what, precisely, was it? To many non-Radicals, it was simply Marxist economics warmed over, but this explanation, though basically true, is too simple. To be sure, the influence of Marx, the leading critic of capitalism, is pervasive in most Radical critiques. But Radical economics is more than Marx. His analysis of capitalism is over one hundred years old and deals with a very different set of capitalist problems. (In Marx's time, capitalism was only in the beginning stages of industrial development and was still characterized by small entrepreneurs carrying on essentially merchant capitalist undertakings.) With this qualification in mind, we will argue, however, that no study of current Radical thought is possible unless one starts with, or at least touches upon, the ideas of Karl Marx. Although a few iconoclastic Radicals will reject a close association with Marxism, the evidence is overwhelming that Marxist analysis is central to understanding the *representative* Radical position in America today.

Since the Marxist critique is likely to be less familiar to many readers than the basic arguments of Conservatives or Liberals, it is necessary to be somewhat more detailed in specifying the Radical position. As will be quickly apparent, the Radical world view rests on greatly different assumptions about the economic and social order than those of the Conservatives and the Liberals.

According to Marx's view, the value of a commodity reflects the real labor time necessary to produce it. However, under capitalism, workers lack control of their labor, selling it as they must to capitalists. The workers receive only a fraction of the value they create—according to Marx, only an amount sufficient in the long run to permit subsistence. The rest of the value—what Marx calls "surplus value"—is retained by capitalists as the source of their profits and for the accumulation of capital that will increase both future production and future profit. As the appropriation of surplus value proceeds, with the steady transference of living labor into capital (what Marx called "dead labor"), capitalists face an emerging crisis. With more and more of their production costs reflecting their growing dependence upon capital (machines) and with surplus labor value their only source of profit, capitalists are confronted with the reality of not being able to expand surplus appropriation. Unless they are able to increase their exploitation of labor—getting more output for the same, or less, wages paid—they face a falling rate of profit on their growing capital investment. Worse still, with workers' relatively falling wages and capitalists' relatively increasing capacity to produce, there is a growing tendency for the entire capitalist system to produce more goods than it can in fact sell.

These trends set certain systemic tendencies in motion. Out of the chaos of capitalist competitive struggles for profits in a limited market there develops a drive toward "concentration and centralization." In other words, the size of businesses grows and the number of enterprises shrinks. However, the problems of the falling rate of profit and chronic overproduction create violent fluctuations in the business cycle. Each depression points ever more clearly toward capitalist economic collapse. Meanwhile, among the increasingly impoverished workers, there is a steady growth of a "reserve army of unemployed"—workers who are now unemployable as production decreases. Simultaneously, increasing misery generates class consciousness and revolutionary activity among the working class. As the economic disintegration of capitalist institutions worsens, the subjective consciousness of workers grows to the point where they successfully overthrow the capitalist system. In the new society, the workers themselves take control of the production process, and accumulation for the interest of a narrow capitalist class ceases.

The Modern Restatement of Marx Of necessity, the modern Radical's view of the world must lack the finality of Marx's predictions. Quite simply, the capitalist system has not self-destructed and, in fact, in a good many respects is stronger and more aggressive than it was in Marx's day. Although the modern-day Radical may still agree with Marx's long-run predictions about the ultimate self-destructiveness of the capitalist order, the fact is that *relevant* Radicals must deal with the world as it is. While the broad categories of Marx's analysis are retained in a general way, Radical thought must focus on real-world, present-day conditions of capitalist society and present an analysis that gets beyond merely asserting the Marxist scenario for capitalist collapse. Indeed, useful economic analysis must be offered in examining contemporary problems.

The beginning point for modern Radical critiques, as it was also for Marx over a hundred years ago, is the unquenchable capitalist thirst for profits. This central organizing objective of all capitalist systems determines everything else within those systems. The Radical analysis begins with a simple proposition about how capitalists understand market activity:

Total sales = total cost of materials and machinery used up in production + total wages and salaries paid + (− in the case of losses) total profits

Such a general view of sales, costs, and profits is, thus far, perfectly consistent with traditional accounting concepts acceptable to any Conservative or Liberal. However, the Radical's analytic mission becomes clearer when the proposition is reformulated:

Total profits = total sales − total cost of materials and machinery used up in production − total wages and salaries paid

It now becomes evident that increasing profits depends on three general conditions: (1) that sales rise, *ceteris paribus* (all things being equal); (2) that production costs (composed of wage costs and material and machinery costs) decline, *ceteris paribus*; or (3) that sales increases at least exceed production cost increases. The capitalist, according to the Radical argument, is not simply interested in total profits but also in the "rate of profit," or the ratio of profits to the amount of capital the capitalist has invested.

With capitalist eyes focused on raising profits or raising profit rates, it becomes clear to Radicals what individual economic policies and strategies will be advanced by capitalists: *Every effort will be made to keep costs low,* such as reducing wage rates, speeding up the production line, introducing so-called labor-saving machines, seeking cheaper (often foreign) sources of labor and materials, and minimizing outlays for waste treatment and environmental maintenance. At the same time, *efforts will be made to keep prices high,* in particular through the development of monopolistic price-making power on both a national and an international scale. In all these activities, capitalists will make every effort to use government economic intervenquite convincing while others seem shallow. However, the reader should remember that, shallow or profound, these are representative political economic arguments advanced by various economic schools.

The sequence in presenting the paradigms is consistent throughout the text: first Conservative, then Liberal, then Radical. In terms of the logical and historical development of contemporary economic ideologies, this sequence is most sensible; however, it is certainly not necessary to read the arguments in this order. Each one stands by itself. Nor is any ideological position intentionally set out as a straw man in any debate.

Readers should look at each position critically. They should test their own familiarity with economic concepts and their common sense against what they read in any representative case. Finally, of course, as students of economics and as citizens, they must make their own decisions. They determine who, if anyone, is the winner of the debate.

Because of space limitations, the representative arguments are brief, and some important ideas have been boiled down to a very few sentences. Also, within each of the three major positions there is a wide variety of arguments, which may sometimes be at variance with one another. Conservatives, Liberals, and Radicals disagree among themselves on specific analyses and programs. For the sake of simplicity, we have chosen not to emphasize these differences but arbitrarily (although after much thought) have tried to select the most representative arguments. Each paradigm's discussion of an issue presents a critique of present public policy and, usually, a specific program proposal.

In all of the arguments, the factual and empirical evidence offered has been checked for accuracy. It is instructive in itself that, given the nature of economic "facts," they can be marshaled to "prove" a great variety of different ideological positions. Different or even similar evidence supports different truths, depending on the truth we wish to prove.