

***The Source of Strength.* Dallas, Texas: Michigan General Corporation, 1977. Address delivered to the Presidents' Club of Michigan General Corporation, New Orleans, 2 April 1977.**

It is a pleasure to be here with you. I have been teaching economics for I hate to tell you how many years and so it is nice to observe a little economics as well.

The great strength of the United States – the reason why this country has become great over the past century and a half – is based primarily, I believe, on the fact that the United States offered an environment, a set of ideas, a set of attitudes, a set of institutions, which gave a maximum amount of freedom to individuals to pursue their own objectives and their own aims as effectively as they could with a minimum of interference from anybody else. It was the belief in individual freedom and the absence of government controls that enabled this country to become the success story it has.

Most of us in this room are descendants of people who benefited from this climate. Our fathers or grandfathers came to this country mostly with empty hands and, because they were left alone and offered an inducement and incentive to make their way, they produced a system under which we are able to have a better life.

That economic climate, that set of political institutions, was reinforced, in my opinion, by the accident of geography. We were separated from the rest of the world by two oceans. We were able to pursue a foreign policy that was largely independent of interference from other countries. We were able to take George Washington's famous advice in his farewell address to avoid foreign entanglements. Thus, we were able to produce an open society and an unprecedented expansion of productivity.

As I see it, that society and that system is today under great threat. In every area we seem to be pursuing tendencies which can only be regarded, in my opinion, as suicidal – tendencies that

are fundamentally opposed to the basic ideas on which we have prospered and developed. This trend is most obvious and most easily observed in the field of governmental intervention.

I am interested in the number of comments made here during the past two days about the problems of government regulations.

The government has expanded to an incredible degree, as evidenced by its spending. Until 1929 government spending at all levels – federal, state and local – never amounted to more than about 10% of the national income. Federal government spending never amounted to more than 3% except during the Civil War and World War I. In other times total federal government spending was under 3% of the income. Today government spending at all levels is 40% of the income; and federal spending is over 25% or about 10 times as much. This has tended to reduce both incentives and opportunities. Even worse has been the extraordinary growth of regulations. There were mentions about the energy problems this winter. Those disruptions were exaggerated by the weather, but their primary source was in Washington, D.C. – not in the weather and not in Texas – but in the government controls which limit the price that may be charged by producers for gas and for oil. We are following a policy under which, in effect, we pay a \$3 a barrel subsidy on every barrel of oil imported from OPEC countries. It is an insane policy and, yet, it has been the major reason for our energy problem.

In the area of public welfare assistance we have been increasingly expanding these programs, spending more and more money, and getting less in return for it. New York City and New York State are the prime examples in this country of what happens when you try to solve problems by simply throwing somebody else's money at the problems.

In the area of foreign policy we have increasingly followed policies which seem to me to be very detrimental to our long-range independence and freedom. Here we have the greatest potential enemy in the world, Russia. The Western World has loaned Russia \$40 billion and has provided it with food to feed its people and with machinery to staff its factories so it can continue to devote over half of its national income to governmental purposes, including a very rapid

expansion in armaments. We are moving as fast as we can to make sure that Russia gets control (I am exaggerating a little in order to suggest the problem) of Africa, where the Simonstown Naval Base in South Africa controls the flow of oil from the Middle East to the United States. Anybody that commands that installation will have a more powerful position on oil than OPEC does.

In the area of education and fundamental values, our educational system has been declining. Instead of being a system designed to unify us and provide a real melting pot, there are increasing tendencies to make it divisive and separate. In the area of ideas, we have increasingly moved away from the idea of individual responsibility to some idea of social responsibility.

Now, of course, there is a good deal of sense to all of these measures. None of these measures is being taken by evil people involved in any conspiracy. These actions are being taken by good people who intend to do good, but who, in my opinion, are doing more harm than good because they are going about it in the wrong way. And, more fundamentally, they are undermining the whole set of values that make this system great.

I believe one of the worst offenders in this respect is business — not you people — not small business, but big business. Over and over again you have the big businessman who talks very effectively about the great virtues of free enterprise and, at the same time, he is off on a plane to Washington to push for special legislation or some special measures for his own benefit. I don't blame him from the point of view of his business, but I do blame him because very often he is shortsighted and ultimately does himself more harm than good. And I do blame the rest of us for not recognizing that this system is not going to be saved by the advertisements of General Electric, General Motors, or Mobil Oil. It will be saved, if it is saved, by the fact that the ordinary people in this country recognize what is happening and the intellectuals in this country change their attitudes and move in a different direction. And I think there are some hopeful signs. But this is all a preface to saying I think that the most hopeful sign, the major source of strength, is illustrated to us by this meeting. The one group in this country that over and over again is on the right side, in my opinion, has been the group of small businessmen. The American Federation of

Independent Business is the only major business organization that is almost invariably on the right side of public issues. The National Association of Manufacturers, the Chamber of Commerce — you name them — the big organizations and big business — they are almost always on the wrong side.

In San Francisco recently I talked at a meeting at which the luncheon speaker was Reginald Jones, the president of General Electric. He gave a speech in which all his general statements were magnificent. He was all for free enterprise, and for strengthening individual initiative, and then he came down to his specific suggestions and every one of his specific suggestions involved making government bigger. First of all, he suggested that the Carter program did not contain a big enough stimulus. Second, he said that after all if other countries subsidized and gave special credits to exporters, the United States has to give special credit to exporters. If other countries have quotas to restrict imports, the United States should have quotas to restrict imports. Well, as I say, this is one of those cases where with such friends we don't need many enemies.

On the other hand, the small businessman has been the source of strength of this country from the very beginning. I really was impressed by the meetings here yesterday and today to see that, despite its embattled state, private initiative is very much alive and there are a good number of very vigorous, energetic, and capable entrepreneurs here who are battling for free enterprise. Though I believe that we are in a very difficult situation, that never in our history have we been so threatened by forces which undermine our basic strength, I don't mean to suggest that the outlook is wholly pessimistic. It isn't. The two greatest sources of strength are, on the one hand, the inefficiency of government and on the other hand the efficiency of small business in finding ways to get around government. That is really the saving grace. People are always complaining about government waste. I never complain about the waste of government. I welcome the waste of government. I had a wonderful teacher once, a teacher of mathematical statistics, who wrote an article on the teaching of statistics. He said pedagogical ability is a vice rather than a virtue if it is devoted to teaching error. Well, government waste is a virtue if it prevents the government from

doing harm. If all of those EPA inspectors you had to deal with were really efficient — if they were not wasting your and my money — just think how much more harm they would be doing.

And more important, the one major reason why there has been a big change in sentiment toward government is because of the recognition by the public-at-large of how wasteful and inefficient government is. A real disillusionment has set in. The Democratic candidate for the presidency had to run on an anti-Washington ticket, a ticket of reducing the scope of government. That doesn't mean he will do it. Every person who gets into the position of being capable of being the president has learned how to rise above principle. So I am not saying he will do it. But the fact that the candidates had to use the rhetoric is itself testimony to the changing attitudes and opinions of government.

I must say I found the recent vote in Congress which turned down the Common Situs picketing bill an extremely encouraging sign that this public sentiment is getting through to Congress. The decision not to press for the \$50 rebate is another encouraging sign that public opinion is getting through to Washington. So I don't mean to say that the outlook is totally bad — not at all. There are some reasons for optimism. But I don't think one can be naively optimistic. If we look around the world we have to recognize that freedom has been declining and not expanding. The number of countries in which people are free to speak their mind and free to follow any activity or industry they want to, has been declining. And that is equally true of the United States. The extent of freedom in the United States has been going down. It has not been going up.

We have the example of Great Britain, from which we derived our basic political principles and our basic values. Britain is in a state of crisis. Unless it makes some drastic changes it will not be one of the free countries of the world for very long. Again, in Britain, there are some signs of change. For the first time in many years you can see some signs of real attempts on the part of both the government and the population at large to deal with the fundamental problems involving

freedom. But at the moment, I think the prospect for the preservation of freedom in Britain remains dim.

So I think we do have a real problem so far as this country is concerned and so far as the free world is concerned, but not one without hope.

I really had not intended to spend so much time on those general comments, but I was led to make them by my interest in hearing the reports from all of you active entrepreneurs. So let me supplement those by a few minutes on the short-term situation. In fact, some of you may be even more interested in that.

I see the coming year as a very strong year, a year of expanding economic activity in the country. That is probably what you can expect for the short term.

We started on an expansion in March 1975. That expansion is now just two years old. The average life of such an expansion has been about 3 to 3½ years in the postwar period, so just pure chronology means there is likely to be one more year, at least, of rapid expansion ahead of us. The less attractive part of that prospect is that we shall see not only a good year in the sense of an increase in total income, total spending and the like, but we shall also see a step-up in the rate of inflation. The rate of inflation came down from a peak of about 12% to about 5% on a year-over-year basis in December of 1976. In the case of all these economic forecasts, remember that nobody can forecast very far in advance. You can only forecast as long as what is already in the pipeline will carry you, because if you try to forecast beyond that you are really forecasting what people are going to do — what the monetary policy is going to be — what the fiscal policy is going to be — and that is as much a question of psychoanalysis as of economic analysis. But with respect to the short-term future, you can forecast economic activities pretty confidently about 6, 9, 12 months ahead because that is as long as the momentum which is already in the pipeline will carry you. With respect to prices and inflation, you can forecast even longer because the rate of inflation has a much longer term momentum than the rate of output.

Inflation is not produced by the trade unions. Inflation is not produced by business. Inflation is not produced by consumers. There is only one place where inflation is produced. That is in Washington, D.C. And the reason that is the only place is because when we speak of the businessman making money, we don't mean that he has a printing press in his basement on which he is turning out green pieces of paper. The only such printing press is in Washington. I say "printing press" — obviously, I am simplifying. In these modern days most money creation is done with the pen of an accountant rather than the printing press. Indeed, it is now done with an entry in a computer, but it is fundamentally the same process as printing paper.

So inflation is made in Washington and it is made by a government which creates money more rapidly than output is growing. On the average in the United States for the past 100 years, and in Great Britain for 200 years, there has been a two-year interval between the money creation and the ultimate effect on prices, and that is why you can look farther ahead in regard to prices than you can with output. My own estimates are that over the next two years (that is about the time it is in the pipeline) the average rate of consumer price increase will be somewhere between 7% and 9% or to pick a single number, around 8%. I don't mean to be precise. This is an area in which nobody can be very precise without error. That is a substantial step-up from the 5% we had at the end of last year, especially since it is going to *average* that over two years. That means it will probably be up in the double digit range or very close to it by the end of next year. We are facing a rise of inflation and, from the point of view of your borrowing costs, the closest relation there has been in the past eight years has been between the rate of inflation and the interest rate. And as the rate of inflation goes up the interest rates will go up, both long and short. And that is also what the market is saying because long-term interest rates are very much higher than short-term interest rates which means that the market is predicting a rise in short-term rates. And, also, if you look at the futures market, the Ginnie Mae market or the Treasury bill market, they are both saying you are going to have decidedly higher interest rates a year from now.

If you look toward the longer term prospect (I notice that many of you in your reports are saying that 1978 is going to be a banner record year and you are also looking forward to 1979), I would only suggest that you have a little caution about 1979 and 1980. As I said, the average expansion has lasted 3 to 3½ years. That would mean if you just went on an average basis, 1978 would see the start of a recession. That doesn't mean it really will because, while the average is 3 to 3½ years, it is like the five-foot-six man who drowned walking across a creek which had an average depth of four feet. The actual experience is that some expansions have been as short as 2 to 2½ years while the longest one has been about five years. So it does not follow that 1978 will in fact be a peak, but we have been having these business cycle recessions for many, many years and we are going to have them again.

As the rate of inflation speeds up there will be increasing pressure on the authorities to try to do something to stop the inflation. There is only one thing they can do effectively and that is to slow down the rate of monetary growth — slow down the amount of government deficit spending and the amount of it which is financed by creating money. But that has a short-run effect of slowing down the economy. You will have a lot of other things occurring. You will have jawboning. You will have attempts at pre-notification, and I would not be at all surprised if you had another round of formal price controls. We have 2,000 years of experience that price and wage controls do not work, but, as Barnum, I guess, has said, a sucker is born every minute. And every government always believes that it can get a little mileage out of re-imposing price controls and it *can*, because they look as if they are working for six months or nine months, or 12 months, and maybe that is all that is needed to get past a crucial election. So, if I were you, I would not rule out the possibility of price controls in the future — I mean in two years from now. I hope it doesn't happen. I am not predicting it will, but I think it is a very real possibility. I find it hard to believe, however, that sometime in the next two, three or four years we will not go through another one of these cycles of the kind we have been going through in the whole postwar period



— ups and downs — ups and downs — in which we are apt to go too far in one direction and then go too far in the other direction.

The problem with these cycles is that, so far as inflation is concerned, they are on an upward slope. Each peak has been higher than the preceding peak; each trough has been lower than the preceding trough. We have been congratulating ourselves that inflation has gotten down to only 5%, December 1976 over December 1975. We forget that when President Nixon imposed price and wage controls in the summer of 1971 it was because inflation was running at the intolerable rate of 4½%. We have a tendency to get immunized, to get adjusted, and to tolerate things we didn't before. So the real question, I think, is whether, and how much longer, that cycle is going to continue before it is going to turn around and start back. And, here again, I don't believe that the signs are all discouraging. If we go through the process that I have described, while we will have a very high inflation rate — 8% on the average of the next two years — that will be *lower* than the rate we had during the last upsurge in inflation, which averaged about 10%. So, while we have by no means reached the stage where we have inflation beat, at least, there is some chance it is stabilizing — that we have started down the adjusting path.

So, as I say, from the short-term point of view of next year it looks very, very rosy, but from anywhere farther down the line it doesn't look nearly as rosy as that.

Let me stop there and I will be glad to answer any questions or make any comments.

## Questions and Answers

**Question:** *It seems to me that pre-notifications of price increases would be a good idea. What is your comment?*

**Answer:** Terrible idea! First of all, pre-notification would be equivalent to a price freeze for a period of time. If you have to give the government 60 days notice before making a price change, then, in effect, you have a price freeze. In the second place, the sensible thing is to prenotify at all

times. Why not pre-notify about price increases and then not put them into effect; and then pre-notify again? Why do you think it's a good thing?

***Question:** When prices start increasing, then we have to start adjusting our prices accordingly. A couple of years ago I was pricing 15% a year inflation into all bids. I thought perhaps prenotification would help us hold down any expected increase.*

**Answer:** Not at all. It would just pre-notify what expected increase to put in. It wouldn't help hold it down. It's like thinking you can keep yourself from having a fever by breaking the thermometer. It isn't you, the businessmen, the people who don't pre-notify, who are producing the price increase. As long as the quantity of money grows more rapidly than output, prices will go up. The only question is will they go up in an open form or will they go up in a concealed form?

You must recognize what is happening. Nobody, you and I included, is ever going to take responsibility for the bad things we do. It's always somebody else's fault. That's equally true with the U. S. Government or with any government. No government official can stand up and say, "I am guilty of causing inflation." Every government official has to say, "It's those greedy businessmen, it's those grabbing labor unions, it's those spendthrift housewives, they are the ones who produce the inflation."

This whole business of pre-notification, the whole business of price and wage control or "jawboning" is fundamentally a public relations exercise to try to blame somebody else for the results that are being produced by government's own policies. Now, I say government's own policies, but don't misunderstand. The people in Washington are businessmen like you. You're selling a product for money. They are selling a product for votes. They are in the business of getting re-elected. Therefore, they are doing what their customers want them to do.

The fundamental blame for inflation has to go back to us, the citizens. We have been saying to Washington, "We want you to spend more money for us; however, we don't want you to tax us, no siree." And so Washington has been listening; Washington has been spending money that

the citizens have been asking it to spend, and it's been refraining from increasing, openly and above board, the taxes. But it has to pay for the difference somehow. If it spends more than it takes in it has to do something. And so, it has been using inflation as a form of taxation. Inflation is the one form of taxation that can be imposed without anybody having to vote for it.

***Question:** Would you care to make a statement on where Mr. Burns stands?*

**Answer:** Oh, of course, I'd be glad to. He stands in the final year of a four-year term as the chairman of the Federal Reserve Board. The statement I've made is really very important. His term as chairman ends in January, 1978. His term as a member goes on to 1984. The question is will Mr. Carter reappoint Arthur Burns. Arthur Burns was a teacher of mine over 40 years ago, and he is still one of my closest personal friends although we have some very sharp disagreements about monetary policy. And I have no doubt that Arthur Burns and his fellow members of the Reserve Board are sincere when they say it is their objective to reduce the rate of monetary growth until we can get back to a non-inflationary level. However, I believe you have to look at what men do and not what they say if you are to predict future actions. And, so far the Federal Reserve has not, in fact, reduced the rate of monetary growth. The rate of monetary growth has been too high over the past two years. It continues too high. Now I believe, however, they are entirely sincere in their statements that they are trying to hold down inflation. And I think they will do the best they can. However, members of the board are subject to very strong political pressures. And experience suggests that when interest rates in general are rising, the rate of monetary growth tends to rise in reaction to it. And thus, I anticipate the best we can hope for is for the continuation of about the present rate of monetary growth for the next year. Beyond that it will be a question of whether or not Mr. Carter will reappoint Mr. Burns. That issue is entirely political. I have no idea.

***Question:** I get the feeling that a group in Washington wants to take us towards or into socialism. Is this true?*

**Answer:** Of course! The public at large wants to go in that direction. It has been electing people who want to take us in that direction. The difficulty is that all of us tend to pursue our own interests. That's both a difficulty and a virtue. What has made this country great has been the environment which has allowed people to pursue their own interests, but not at the expense of somebody else. In the same way members of Congress want to pursue their own interests. That means doing things that will get them elected. Individuals who become bureaucrats want to pursue their own interests. That means getting as large an appropriation as possible, having a large staff, and having as much power as they can.

Also, the people now running the country reflect the intellectual atmosphere of some two decades ago when they were in college. Most men's basic ideas are formed in their teens. Very few people change their fundamental values and ideas in later life. In the intellectual world there was a very long-term shift of ideas away from the 19th Century belief in individualism and self-reliance in the direction of social responsibility and the idea that people were not to blame or were not responsible for what happened. Also pushed was the idea that things could be conducted more effectively if they were conducted through political mechanisms rather than through the market. Now that belief no longer has the strength it once had and is now moving in the opposite direction. But the old theories still dominate what happens in the political world.

I have no doubt at all that there are many people who are seriously, honestly, trying to move the country toward socialism. I don't view what is happening as an evil conspiracy. I am always being deluged with people who send me conspiracy books or write me about the tri-lateral commission that had a conspiracy or the international bankers who have a conspiracy. I'm sure all of these conspiracy stories are wrong. It's only that people like to have a devil to blame. They don't like to think things are happening because of forces other than human evil. There is no conspiracy. Sincere, well-meaning people are doing harm.

We have been going in the wrong direction because people's ideas have been wrong. And, it is hard to turn them around, because once you move in a direction it is much easier to keep

moving in that direction than it is to reverse it. It's easier to enact a law than it is to repeal it. Once you enact a law, vested interests develop to keep it. This is what I was saying about the business community. Every businessman is in favor of free enterprise – for somebody else, but not for himself. He wants to retain whatever privileges there are and whatever governmental controls there are.

The same thing is true with all the rest of us. Two years ago, when President Ford held those much-publicized meetings in Washington, D. C., out of which emerged that silly WIN Program, I remember sitting there and listening to one representative of a special interest group after another speak. This meeting was supposed to develop methods to fight inflation and each speaker said, of course, in order to fight inflation we have to cut the budget. The way to cut the budget, he said, is to spend more money on us. That's what the farmer said, that's what the businessman said, that's what the highway people said. So, it's very, very difficult to turn it around once you get into that kind of system. Not only do we have very strong forces driving us toward socialism, we are largely there already.

You people think you own Michigan General. Let me tell you something, the U. S. Government owns 48% of Michigan General. It shares in 48% of your profits, it shares in 48% of your loss as long as you have some profits to offset them – except when you are able to devise clever schemes to outwit them. That's why we have so many high-paid tax lawyers in the country. But fundamentally we are 48% along the way toward socialism because 48% of every corporation in this country is effectively owned by the U. S. Government. Some years back, I was in Yugoslavia and I came to the conclusion that there was, I think, a 16 percentage point difference between the degree of socialism in the United States and in Yugoslavia. At that time approximately 64% of all earnings in that country were going to the central government. Of course, we have been moving in the direction of socialism. The only saving grace is that the socialist segment of the country is so much less efficient than the free enterprise part. If the government were spending the income it takes in efficiently, then heaven help us!

*Question: Are there specific areas of government spending that you personally think should be significantly reduced?*

**Answer:** Of course, name anything. As you probably know, the part of the budget that has been expanding most rapidly are the payments for transfer income. The budget of HEW is now 1½ times as large as for the Defense Department. And most of that money is doing harm and not good.

I would certainly abolish food stamps. I would certainly reorganize and eliminate all of our present welfare programs and replace the whole kit and kaboodle with a single negative income tax which would involve a much smaller expenditure. I would certainly save a great deal of money by abolishing the S.E.C., the F.C.C., the F.T.C.

I'd put all of the lawyers out of business. The law profession is the only one I know in which the supply creates its own demand.

Of course, such revolutionary changes cannot be achieved overnight. First the trend has to be reversed. In my opinion, the one movement that has the most potential is the one which calls for state or federal constitutional amendments setting limits on government spending as a percentage of income. The first attempt along these lines was in California by Gov. Reagan. The so-called Proposition One included a provision that would have limited total spending by the State of California to a specified percentage of the income of the people in California. Another provision would have rolled the limit back by one-tenth of one percent each year for 15 years. That proposal was defeated about 54 to 46.

This past year, as some of you know, there was a similar plan, Proposal C, which proposed to limit spending in the State of Michigan to 8.3% of the income of the people of the state. That also was defeated. In both cases these amendments were defeated by a last-minute blitz by state employees, primarily behind the skirts of the League of Women Voters. The Michigan Educational Association in the last two or three weeks poured something like \$500,000 into a media campaign. The earlier polls had shown a two-to-one margin in favor of Proposal C. It was

finally defeated by something like 53 to 47 or 54 to 46. And, there is little doubt that the main reason was the extensive campaign by the Michigan Educational Association which is a trade union of the schoolteachers. It was carried out not only on television, but a friend of mine who had children in the Michigan schools told me the children were coming home from school carrying propaganda distributed in school against Proposal C.

I think that illustrates the fundamental problem which is that every business with special interests is going to try to preserve its own special interests. Many individual teachers, of course, were in favor of Proposal C and were not part of the campaign, but the Association people knew that if the state government's spending was limited then they would have to get approval from local authorities, and it is harder to get approval from local authorities for boondoggles than it is at the state level.

The Michigan case was a fascinating one. On the Saturday before the election the proponents of Proposal C had filed a suit to enjoin the Michigan Educational Association from presenting misleading and false propoganda. The judge issued a ruling on that Saturday in which he stated explicitly that the propoganda the Association was issuing was false and misleading. But, he refused to enjoin it on grounds of avoiding prior restraint. Not a single major media outlet, neither television nor newspaper, carried that story before the election that Tuesday. Not a single one. And that was because most of them were located in Detroit which was hoping to get money from the state to pour into its own problems.

On a national level, the Southern Governors Conference a few years ago appointed a task force on limiting government spending headed by Gov. James Edwards of South Carolina. And that task force came up with the proposal for a federal constitutional amendment to set a limit on federal spending as a percentage of income which, I believe, was endorsed by the whole Southern Governors' Conference.

These moves toward constitutional amendments limiting local government spending are the most promising thing on the horizon. I don't think we should be discouraged by initial defeats.

Look at what is happening with national health insurance. The national health insurance is a terrible program which would worsen medical care and do enormous harm to the medical industry in this country. It has been knocked down and-defeated time and time again, yet its proponents keep coming up with it and keep coming up with it. Maybe sooner or later it will be passed.

And in the same way I don't think we should be discouraged because our measures on the other side are knocked down. We have to keep coming up with them. There is a move in California now to put another proposition, like Proposition I, on the ballot. There is even some chance that Gov. Jerry Brown might support it. And also there is a continuing move in Michigan. There are some people in Massachusetts who are working to put such a proposition on the ballot in that state and in other states. Some of you here are from northern New York and Congressman Jack Kemp from the Buffalo area has been introducing an amendment along these lines in Congress for some years. He and some others are pushing it. So I think there is a movement under way trying to do something along these lines. I would hope that we could get some of the low-spending states like Texas to introduce amendments of this kind to help get the ball rolling, and bring national attention for such proposals.

However, I believe that amendments to balance the budget are not the way to go. I have pointed out that the so-called fiscal conservatives who have argued for balanced budgets have, in fact, allowed themselves to be used as front men for the big spenders. What is typically happening on both the state and federal levels is that the big spenders get some big bills passed resulting in deficits. Then the fiscal conservatives scratch their heads and say, "Oh, this is terrible, we have to do something about this." So they go to work and encourage the imposition of taxes to close the deficit. As soon as the taxes are enacted and everything is in balance, then the spenders are off again. I say forget about balancing the budget. That isn't important. The important thing is to keep total spending down.



**Question:** *In your interview on 60 Minutes in reference to Great Britain you stated that the United States was on the same track as Great Britain, only 20 years behind. You also stated, hopefully, that we had 20 years to take corrective measures. Do you think the United States will take corrective measures?*

**Answer:** That's difficult to answer either yes or no. It's just like saying if you toss a coin, do you think it will come up heads? I think our destiny is in our own hands. We can take corrective measures if the public at large wakes up, although the odds are against our taking corrective measures.

**Question:** *Is there any possible machinery which would help us do something about inflation, where we have these phenomena like OPEC, the coffee prices or anything else?*

**Answer:** OPEC did not cause inflation and rising coffee prices did not cause inflation. Don't kid yourself. That's not true. OPEC has made oil expensive but you must distinguish between prices of particular products and the price level in general. OPEC has made oil expensive and imposed a very heavy cost on us. That cost is roughly equal to 1.5% of our national income. To that extent you can say that our price level is 1.5% higher than it otherwise would be. Let me show you why you have to stop a moment before you say that OPEC causes inflation. Have you seen in the newspapers or elsewhere any stories saying that Texas Instruments has been causing deflation? I use Texas Instruments as an example, but consider the whole computing industry. The cost of computing services has been reduced to 1/10 or 1/5 or less of what it was 10 years ago. If higher oil prices cause inflation, why don't lower computer costs cause deflation? Neither the one nor the other causes inflation or deflation. They are changes in relative prices. Oil prices have gone up and computing prices have gone down. If people had to spend more on oil they would have less to spend on other things and the prices of other things would go down.

OPEC has not caused inflation. It is another case of the government trying to find scapegoats. They want to blame the Arab chiefs. Let me put it another way. If OPEC causes inflation why does it cause zero inflation in Switzerland, 5% in Germany, 10% in the U.S., 20%-30% in Japan,

25% in Britain? It's the same factor affecting everybody – why should it have such different results? OPEC has not caused inflation. But to go back to your basic question, if you ask if there is anything we can do about inflation, I don't know whom you mean by "we." Do you mean the government? Individuals? Businesses?

**Comment:** *You name it.*

**Reply:** The government can do one thing about stopping inflation. It can stop printing so much money. Businesses can try to protect themselves against inflation by using escalator clauses to the widest extent that they can. I am in favor of the widespread use of escalator clauses as a way of reducing the harm done by inflation, although escalator clauses are not a cure for inflation. They are aspirin.

Unfortunately there is no really good way the ordinary individual can protect himself against inflation. On the average, over many years, equities ought to be a hedge against inflation. Over short-term periods they are very unreliable. Land has tended to go up in price. On the whole, the most effective hedge against inflation is high living. Expensive houses, apartments, jewelry, or paintings tend to go up with inflation. In addition, you get income from them that you don't have to report on the tax returns. So you simultaneously get a hedge from inflation and a shelter from taxes. But beyond that there, unfortunately, really is no effective way for the ordinary person to protect his assets against inflation.

**Question:** *How about boycotts?*

**Answer:** Boycotts are just plain silly! They are a way of working off frustrations but they have no effect. If people stop buying that doesn't reduce inflation. Nobody boycotts forever. People boycott with the belief that if somehow they don't buy today they can buy tomorrow instead and that will make a difference. That has no effect. There is no more sense in thinking of boycotts as a cure for inflation than there is thinking of pre-notification or price and wage controls as cures for inflation.

**Question:** *Do you foresee an upturn in corporate loan demand this year?*

**Answer:** That's a highly specialized question, because you really mean corporate loan demands from banks. There will, of course, be an upsurge in corporate loan demands if the economy expands as we expect it to. How much of that will take the form of demand for bank loans versus open market issuance I'm not enough of an expert on financial markets to say. There will be an upturn in the aggregate of the corporate loan demands if, indeed, our expectations of a year of rapidly rising total production are correct.

*Question: How does the Council of Economic Advisors respond to your views?*

**Answer:** The job of the Council of Economic Advisors is not to agree or disagree with my views. Their job is to serve the President. The question is, what is in the political self-interest of the President? The fundamental thing that is in the self-interest of the President of the United States is to be sure that 1980 is not a depressed year. That is a very tough assignment. I would not like to have to be the economic counselor who had to guarantee that you could achieve that goal. First of all, it should be clear that the power of the President is limited. He has considerable influence but very little power. The fundamental power to affect economic conditions is in the hands of the Congress on the one hand and the Federal Reserve on the other. The President does not directly control either.

Even the effects of measures that the Federal Reserve takes or the Congress take cannot be predicted accurately.

But to go back to the problem, let me sort of change your question. What is the task that the Council of Economic Advisors must address itself to? Well, as I say, I think number one is to make sure 1980 is a prosperous year. As I say, that is not an easy task and let me show you why. Just look at the chronology. On the average, expansions have lasted in the post-war period from 3 to 3½ years. That would mean on the average we would have a peaking out in middle to late 1978. That would mean we would have a recession in 1979. Well now, post-war recessions have lasted a year to a year and a half, so if you could hold that recession to exactly a year, in 1980 we would be in good shape. However, it would be better to have the prosperity apparent by mid

1980, and not wait until the end of the year because numbers don't come out that fast and people don't react that fast.

What is the alternative? Obviously from a political point of view the best thing for the President to do would be to produce a recession in 1977. There's no doubt politically that would be ideal. Because then the bad news would be over with early in the term and the administration would have time to turn it around. Even with a very long recession the nation would be out of it before 1980. However, from a political point of view it would be suicide to take measures openly to produce a recession in 1977. The next best alternative is to try to keep these things going until 1980. That would make it the longest expansion in the post-war period and one of the longest in 150 years. Again that is not an easy assignment. I think the one prediction you can make is that insofar as Mr. Carter has any control over the course of events he won't attempt to produce a great deal of steam until 1979. I expect he will try to keep things going as slowly as he can for 1977 and 1978 and then step on the gas for 1979 and hope to get a final burst in 1980.

***Question:** What do you think is the inflation outlook in relation to capital spending plans?*

**Answer:** In capital spending as in so many other items you've got to distinguish between the point of view of each individual businessman and the society as a whole. Total capital spending does not depend fundamentally on the plans of people like you and me. Capital spending depends on how much is available to be spent. There is a total pool of savings and how much is available for capital spending depends upon how much of that pool the government borrows. The government has been taking a third to a half of that total pool. If the government continues to take a third to a half of that total pool there is not going to be much left to fund a rapid expansion. What individual plans do is to determine at what interest rate that pool will be distributed. Let's suppose that all enterprises are pessimistic about capital spending and none of them is going to go in for big programs. That situation will tend to make the interest rate decline and that, in turn, would mean a housing boom, because then the funds will be available for mortgages and for

building houses. I really think you want to approach the capital spending problem from the angle of asking what happens to the total pool of funds.

*Comment: I think the whole country wants too much for nothing.*

**Reply:** I put it a little differently. I think everybody always wants too much for nothing. I hope we will always continue to want too much for nothing. There's nothing wrong with that. What makes the country great is that people want to get a lot for nothing. Each of you people here, you want to get as much as you can with as low a cost as possible. If you could produce more and pay nothing, you wouldn't object.

*Comment: It doesn't work that way though.*

**Reply:** Of course it does. What has made this country great is precisely that people have discovered how to get something for nothing. The real problem, in my opinion, is trying to do good with somebody else's money. If you try to do good with somebody else's money two things happen. In the first place nobody spends somebody else's money as carefully as he spends his own. So much of what you try to spend on doing good is wasted. In the second place you cannot spend somebody else's money unless you get it. Therefore, you have to use a policeman to take it away from him. And so force is at the bottom of doing good with somebody else's money. That's why this glorious, noble idea of the welfare state always ends up in financial crisis and the loss of freedom. If people want something for nothing that's fine – as long as the only way they can get it is by offering somebody else something that he wants.

*Question: Back to the question of capital spending. In 1976 in particular, there was a tremendous build up of cash in such areas as savings and loans, etc. And yet, we still had inflation. Why was that?*

**Answer:** This was a period in which there existed the largest deficits by government of any post-war expansion. Those deficits absorbed those cash balances you are talking about. Those cash balances were being invested in government securities.

Now the effect of the government deficit was to enable consumption to rise. The distinctive feature of this expansion was that consumption spending constituted a much larger portion of the total expansion than it typically does and capital expenditure constituted a smaller portion. That's because everybody is talking about the "crowding out" and people are saying, "see we should not have crowding out." That's nonsense, we have crowding out, but in a free market with a free price system, crowding out doesn't take the form of people lining up to buy something and not being able to get it.

In the same way there has been crowding out in the capital market. The government has borrowed the funds and indirectly has financed the consumption by the people. Say those funds were used to pay the welfare checks, or unemployment compensation, or what not, enabling consumption to rise. As a result there weren't any funds left for capital spending. So the low level of real capital spending is the exact counterpart of a high-level government deficit. On the balance sheets it shows up by corporations being liquid and banks increasing the fraction of their assets in the form of Treasury securities.

***Question:** You mentioned a negative income tax. Would it help to improve our welfare system?*

**Answer:** Well I think it is a better solution in the short run. I don't want to say that any type of negative income tax is better than the existing system. But there exists a negative type of income tax that is better. Under the current positive income tax if a family of four has an income of \$5,000 and exemptions are \$4,000 it has \$1,000 of taxable income on which it pays a tax. Under a negative income tax if that same family of four has an income of \$3,000 it would have a negative taxable income of \$1,000 and the tax imposed on it would mean a refund or a subsidy for that family. So a negative income tax is simply extending the present income tax below the exemptions as well as above and using it as a device for assisting people with very low incomes. How it works depends upon the break-even point, at what level you shift from the positive to the negative side, and how high the tax rate is below. That is to say that if you had 100% tax rate

below it would be terrible, because it would destroy all incentives to earn income. Our present welfare system is a collection of a number of programs which together is a monstrosity. Some people who are able to qualify under a half dozen programs will be able to get very much higher incomes than they can earn by working. Other people whose needs may be just as great may not be able to qualify for any of the programs. Of the total amount of money being spent on the so-called welfare program, a large fraction is going to people for whom there is no justification for such subsidies whatsoever.