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# THE U.S. ECONOMIC SYSTEM—WHAT IS IT BECOMING?

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Turning points are the most difficult events to predict in either economic or human history. In many areas (the weather, the GNP, etc.) the naive statement that tomorrow will be like today predicts as well as most sophisticated models, except that this naive prediction system cannot predict any turning points. And it is precisely the turning points that are of interest. At the moment, we are bombarded with statements that a fundamental long-run economic turning point is at hand. Energy, the environment, shortages of raw materials, or something else is going to force us to change our economic life-styles and institutions dramatically. Which, if any, of these statements are true? Or conversely, what ignored events, if any, might force fundamental, but as yet unrecognized, changes?

I have always been intellectually intrigued by turning points. We tend to forget the false, though widely believed, predictions about turning points. Perhaps the most dramatic example occurred in the year 1000 when some substantial fraction of the population believed that the end of the world was at hand in accordance with Biblical prophesies. But nothing happened and the whole incident is now but a minor footnote in the history of human mistakes.

Even more interesting, however, are the actual turning points. I plague my historian friends with the question of whether those who were alive at the time realized that they were participating in a turning point. The usual answer is that they did not. I am told that even such a dramatic turning point as the French revolution was not perceived as such for some period of time after what, we would now all agree, was the beginning of the French revolution.

If we could quantify human history, I suspect that we would find a very poor prediction record on turning points. We predict turning points that are not turning points, and we do not predict those that actually are turning points.

## **SOME PREDICTED TURNING POINTS THAT ARE NOT TURNING POINTS**

### **Trend Toward a Leisure Society**

Many people are predicting that with rising productivity and incomes, the United States will become a leisure society and that

the basic problem will be finding creative uses for leisure. This is a prediction that is slightly out of fashion at the moment, but one that enjoys a recurring life. The only problem is that it is factually incorrect. As our productivity and incomes rose, we used to take some of this increasing productivity in the form of leisure, but not any longer. Since the late 1950's, annual hours of paid work have risen. From 1960 to 1973 the average male increased his annual hours of work from 1,836 to 1,844 hours per year and the average woman increased her hours of work from 1,168 to 1,296 hours per year. This 11 percent increase for women, together with an 18 percent increase in the proportion who were working, resulted in a 29 percent increase in the hours of paid female work per year.

Analysis of unpaid household tasks indicates that the increase in paid female work was not matched by an equivalent reduction in unpaid work. Women are simply working more hours per year now than they did fifteen years ago, and men have stopped their long-run movement toward shorter hours of work. If we look at men in the prime working years (25–64), hours of work have also gone up rapidly. Only the increase in college enrollments and retirements have prevented average hours of work from rising rapidly.

At the moment we are not heading toward a leisure society but toward a society that is more work oriented than it has been. The reasons for this movement are not clear, but they include the probability that most Americans like their work, that they may find leisure on the job more fun than leisure at home, and that they have discovered capital intensive leisure activities—second homes, power boats, etc. They want more goods but less time for their leisure.

### **Trend Toward a Service Society and Economy**

Many people contend that the United States is becoming a service society and economy. This prediction seems to be made with a considerable degree of anxiety but without any clear idea of the horrible consequences that would follow if it were true. In any case, what is actually happening to the economy is quite different from what is implied by the use of the word *services*. Normally we use the words *service industries* to connote personal service firms that are small-scale industries with low capital-labor ratios. The official definition of service industries, however, is everything except extractive industries (agriculture and mining) and manufacturing. Thus it includes capital intensive industries such as power companies and many industries such as retail stores that are simply an integral part of the process of producing and distributing goods.

If we reclassify industries where they belong in terms of the substance of the word *services*, the shift to services is much less dramatic. Between 1950 and 1970, the proportion of the labor force engaged in producing and distributing goods actually rose from 63 to 65 percent of the total work force. Personal services, what is normally meant when we use the word *services*, actually dropped from 10.5 percent to less than 9 percent of the labor force. The growth in services was all in social services, which grew from 12 to 22 percent of the labor force. Within social services, the health industry accounted for 30 percent of the increase, and the education industry accounted for 50 percent of the increase.

As a result, the shift to services narrows down to the growth of two industries, health and education. Both of these are capital intensive large industries that are not exactly what the editorialists are referring to when they talk about the service economy. In addition, the growth of the education industry has halted. Extractive industries have been declining, but they have now become such a small fraction of the total labor force that further declines can have very little effect on the economy.

### **Trend Toward a White Collar Society**

The distinction between white and blue collar jobs has totally lost significance, if it ever was significant. The traditional distinctions were mental versus manual work, promotion possibilities versus no promotion possibilities, dirty versus clean, heavy supervision versus light supervision. In our classification system, a roomful of women sitting at key punches wearing multicolored shirts will be classified as white collar workers while a roomful of women wearing white coats sitting at an electronics assembly line will be classified as blue collar workers. The differences escape me.

Half of the increase in the proportion of white collar workers from 1950 to 1970 can be traced to clerical workers (typing is, however, a manual skill), and the other half can be traced to professional workers. One-third of the latter are school teachers, and a substantial fraction are health personnel.

### **The Energy Crisis and the Nature of Economics**

Much has been written lately about the energy crisis and the resulting pervasive changes in the economy. But this is not really a turning point. While economic history is to some extent a history of falling relative prices for raw materials and energy, that history is not without interruption. The fundamental question is whether we

are now going to be facing an era of rising relative prices for energy or raw materials. Since the raw materials crisis of a year or two ago has faded from view, and since it is similar to the energy problem, let us focus on energy.

We need to make two distinctions in evaluating the current energy "crisis." First, there is a difference between the short-run effects of an economy adjusting to a new higher price of energy and the long-run effects of that higher price. The short-run effects are created by our having purchased durable items that we would not have purchased had we known about the rising price of energy. If the price of gasoline doubles, the gasoline bill can be held constant by buying a car that gets twice the gas mileage. Someone who owns a gas guzzling monster is in trouble, however, until it comes time to replace that economically obsolete car with one more suited to the current price of energy. While the car adjustment problem cures itself in five to ten years, the housing adjustment problem takes longer. If we had known the price of energy, we would have built different houses—fewer windows, more insulation, etc.—but given that we have houses geared to cheap energy, we will have enormous heating or cooling bills if we maintain our old life-style.

The importance of this distinction is that a radically higher price for energy creates short-run discomforts and alters the nature of the goods that we will buy in the long run, but it does not fundamentally change the nature of the economic system or its rate of growth. This is especially true since the gross national product is exactly what the term indicates it is—a measure of the gross output of the economy. As a result, higher prices for energy get reflected in a larger gross national product when a barrel of oil is produced.

What is even more important, the size of the change in price of energy should not be exaggerated. One of the ways to evaluate the real cost of any commodity is to look at the working time or fraction of one's income that has to be sacrificed to obtain that good. The average family's gas, oil, and utility bills have certainly gone up relative to their income or working time since the Organization of Petroleum Exporting Countries got under way, but the increase in the "effort" price of energy should not be exaggerated. Given June prices, the average family's effort cost of energy has been pushed back to 1970 levels. Assuming that oil prices will be deregulated and that OPEC will raise the price of oil by two dollars per barrel this fall, the average family's real cost of energy will revert to 1968 levels. While it is painful to have the economic clock pushed back five or seven years with respect to any product, such a reversal is hardly a disaster, an unprecedented setback in human

history, or a significant change in the direction of economic history.

Second, we need to distinguish between changes forced by nature and changes forced by men. The current price of energy is not something forced upon us by nature and natural scarcities, but by the organization of a man-made cartel. What man can make, man can break. Without OPEC we would now be in a period of rapidly declining energy prices regardless of what we believe about the long-run availabilities of energy and the twenty-first century. For all of these reasons, I do not think that the current energy crisis is a fundamental turning point in history.

### **The Education Industry and the Economy**

There is no doubt that education is now at a turning point. Demography made it the growth industry of the 1950's and 1960's, and demography will make it a declining industry in the second half of the 1970's and the 1980's. While those of us in the education industry are going to find it painful to go from a growth industry to a declining industry, the economy will barely notice the transition. The decline of educational employment will be minor in comparison with the decline of agriculture as an employer.

The economy is also apt to adjust rather smoothly to an increasingly educated labor force. Expectations and demanded skills adjust so that the economy will continue to run even though its labor force has a larger and larger fraction of college educated workers. One of the glories of the U.S. higher education system is that it has not yet started to turn out large numbers of workers who refuse to take jobs beneath their dignity. Expectations are usually realistic and adjust rather rapidly when the traditional openings for college graduates diminish.

### **A TURNING POINT OF UNKNOWN IMPACT**

Leaving aside the oil rich nations who inherited wealth, the United States has had the world's highest per capita income and standard of living for all of this century. Using foreign exchange rates, it looks as if we have just been passed by Sweden, Denmark, and Switzerland and are about to be passed by West Germany and Norway. More careful studies using the prices of all goods, not just internationally traded goods, come to the conclusion that we still have some period of grace before we are second best. West Germany's standard of living is about three-fourths of that of the United States and Sweden's may be seven-eighths. But there is also no doubt that the rates of growth in these countries have been

higher than ours for the past twenty-five years and that they ultimately will catch up.

The unknown is our reaction to retreating into a second best position. Will it be to change our institutions to accelerate our rate of growth and maintain our position, or will it be to ignore the problem and sink into economic obscurity like the English? Obviously, no one knows what our reactions will be, but either way, a turning point will have been reached.

If we decide to accelerate our rate of growth, major changes will be necessary. Almost since the industrial revolution began, our productivity has grown at a rate of slightly less than 3 percent per year. What has changed is not our performance, but that of others. Ours has stayed the same and theirs has improved. Given this long history of a rather constant performance, there is every reason to believe that fundamental changes would be necessary to increase the U.S. rate of growth of productivity.

On the other hand, if we choose not to respond, a turning point will also have been reached. After a long period of supremacy, we will no longer be able to claim that our economic system is best at delivering the goods. Other economic systems—most notably Sweden—will be able to claim that they deliver both better short-run and long-run performances. Given what we know about human nature and “low income” countries, it is clear that sooner or later a poor relative economic performance creates political demands for change.

#### **CURRENT ECONOMIC TENSIONS AND THEIR LONG-RUN IMPLICATIONS**

While I do not believe that the economy is at a turning point in economic history, there are three current problems that will force changes in our expectations or the way in which our economy works. These are the problems of inflation and unemployment, the mix of private and public enterprise, and an economic time horizon that is longer than our political time horizon.

#### **Inflation and Unemployment**

Unfortunately, inflation is endemic in our mode of economic production. We have large and growing concentrations of economic power in both the product market and the labor market. These concentrations of economic power can be prevented from raising prices or wages by severely depressing the economy—that is, creating low levels of demand and high levels of unemployment—but whenever the economy is near capacity, unions

and companies find it possible to raise prices and wages faster than would occur in a competitive economy. The nature of the problem can be clearly seen by comparing the reductions in demand that are necessary to cause price reductions in the automobile industry with how easily the prices of farm commodities can fall whenever supplies rise relative to demand.

Economic power and the capacity to raise prices and wages faster than would occur in a competitive economy are buttressed by modern fiscal and monetary economics. All of the major players in the economic game know that the government is not going to let the economy collapse no matter how much they raise their own wages or prices. Thus, in a very fundamental sense, the discipline of the market is not present or is very much attenuated. No matter how wisely or foolishly the government manipulates its macroeconomic policy instruments, it cannot achieve low rates of both inflation and unemployment.

The standard economic solution to this problem would be to break up the concentrations of economic power that cause the dilemma in the first place; yet current economic discussions are marked by a complete absence of this suggestion. We feel that these large concentrations of economic power either contribute to the long-run growth of productivity or are so powerful that any attempt to break them up would be futile.

Despite the current cases against IBM and AT&T, I think it is clear that the antitrust solution is intellectually bankrupt. Prosecutions go on, but I know of no one who thinks that any of the economy's problems will be solved even if these prosecutions are successful. The antitrust effort has a life of its own, but it is a life that is now completely void of any intellectual rationale. We have simply reached the point where no one thinks that the whole economy can revert to the competitive mode that actually exists in the agricultural area.

If we look at democratic industrial powers, it is clear that no one has found an acceptable solution to the problem. As a result, the real questions revolve around finding ways to live with the economy as it exists.

Basically there are two options. We could run the economy at something approaching full employment and then find ways to keep the resulting inflation from hurting anyone too severely. Or we could run the economy at a level where inflation is not a problem and find ways of keeping the resulting unemployment from hurting too severely. In the first case, we would adopt some form of index-



ing to make sure that all prices and wages rose together rather than at very different rates. And in the second case, we would use some form of public employment to create the full employment that could not be achieved in the private economy. Either solution would, however, substantially alter the nature of the current economic system.

There is a third option of doing what we are now doing—running the economy at unacceptable levels of both inflation and unemployment—but I assume that this is an intolerable long-run solution.

### **The Mix of Public and Private Enterprise**

Long ago, we widened the scope of choice beyond that of socialism versus capitalism. These are merely ends of a continuum along which exist a multitude of choices including the simultaneous existence of government and private corporations (electric power production and distribution, parcel delivery), regulated industries, and joint public-private enterprises (Comsat). The real problem is not to decide on a superior method of organization for the entire economy but to decide which method is superior in different sectors of the economy. There is also no reason to assume that a superior method of organization will remain the superior method for all time.

The perfect example is the transportation industry and the Interstate Commerce Commission. When the ICC was founded it played an important role in offsetting the monopoly power of the railroads. Over time, however, the transportation industry became a competitive industry with the development of cars, trucks, airplanes, pipelines, etc. Yet the regulations based upon the assumption of a monopoly continue to exist. They exist, not as a result of sloth, but because they have built up a set of vested interests that benefit by their existence. The rationale has disappeared, yet we seem incapable of changing the rules. The railroads have deteriorated to the point where deregulation cannot save them, but we seem incapable of creative solutions such as nationalization of the roadbed and competitive traffic on that roadbed.

The issue is not regulation versus deregulation, but starting regulations in some areas and ending regulations in others. We seem unable to do either.

One of the benefits of being a defeated power in a war, such as West Germany or Japan, is that all of the economic institutions are swept away and have to rejustify their existence and usefulness.

Vested interests do not have to be overcome since most vested interests have been destroyed. The same thing was true in the Great Depression. This is not to say that we should deliberately lose a war, or have a Great Depression, but we do need to find a way to periodically change our institutional arrangements. As yet we have not found it. Our economic institutions have not been significantly altered in the last three or four decades and are beginning to show their age. But we have no effective way to reinvigorate them. We need the peacetime equivalent of a popular war in order to get some basic changes in our institutions.

### **Economic and Political Time Horizons**

At the moment the economy is facing a set of problems where the time necessary to solve them is so long that the politicians who initiate the solution would receive all of the blame for stepping on economic toes and receive none of the credit for solving the problem. Project Independence is a perfect example. People often ask why something does not happen. There is an easy answer. If a set of projects for energy independence were to actually be undertaken, they would dislocate a number of economic interests. Yet they could not achieve energy independence until the late 1980's at the earliest. By the late 1980's most, if not all, of the current generation of politicians will have retired, voluntarily or involuntarily. Today's politicians will be blamed for the dislocations that Project Independence causes but they can receive none of the credit. Still there is no way to achieve energy independence in less than fifteen years. As a result, we do nothing. Our economic and political time horizons are simply out of joint. Similar problems exist in the transportation industry.

The solution to this problem is not at all easy to envision. The time necessary to reach an economic solution cannot be cut, and we do not wish to elect our leaders for life. What we really need is leaders who see what must be done, know that it will be unpopular initially, and are willing to take the blame and risk defeat with little chance of receiving any immediate credit. Unfortunately, these people either do not exist or are unelectable if they do exist.