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The World Economy in Perspective*

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In any consideration of the world economy, such as that on which I venture here, we find ourselves reflecting on the truly great changes of recent times. Once concern would have been overwhelmingly with the problems and the dynamics of the nonsocialist economies. The socialist world, that of the Soviet Union, China, Eastern Europe, was a fixed point on the economic compass. Change belonged to the capitalist countries alone. It was of them one spoke.

Now no longer. A view of the world economy today must embrace both the capitalist and socialist systems; for both this is a time of major transition.

There is change, in the largest sense, both in the two systems and in the relations between the two. For seventy-one years we have had a rigid bipolar conception of the world economy. Each of the two systems, capitalism and socialism, more often called communism, was presumed to be governed by its own firm and unchanging ideological rules. Capitalist principles; socialist/communist principles. Neither system was thought to work perfectly. Nonetheless, modification and reform, if they were to be acceptable, had always to be within the larger framework of the controlling ideology. Nothing more condemned an action in the capitalist world than to say that it was a step toward socialism or, God forbid, communism. Nothing was more condemned in the socialist *cum* communist world than the assertion that something violated socialist principles. Thought in both systems was regularly arrested by such condemnation and the fear of such rebuke. Much needed remedial action in both systems was averted by the need to avoid such risk. Each system had a barrier beyond which speech and advocacy were considered subversive.

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At this moment in history the ideological commitment confining thought and action has broken down in both systems, or is breaking down. This is a decisively important development. We see it in a remarkably vivid way in the Soviet Union, where a critical economic discussion, unparalleled in Soviet or even Russian history, is in progress. This is the discussion of reforms — of *perestroika*. But, if less vividly, the same thing is happening in the United States. Eight years ago Ronald Reagan came to the American presidency with rhetoric and, if less clearly, a program designed to restore the classical free enterprise world; to restore the world, if not of Adam Smith, then of Friedrich Hayek and Milton Friedman. It did not happen. The free enterprise speeches continued but not the program. The role of the state, ardently condemned by Mr. Reagan, was greatly enlarged. The broad intervention by the state to sustain the level of output and employment as envisaged by Keynes continued, and with a volume of fiscal support to the economy from budget deficits and overseas borrowing that Keynes himself would never have countenanced. The welfare system — old age pensions, unemployment compensation, lower-cost housing, aid to the poor — which was held by the more devout of Mr. Reagan's supporters to be a step toward socialism, has, with some impairment, survived. None of it is under serious attack in the present election campaign.

Meanwhile, suffering farmers turn as successfully as ever to Washington. So do failed or failing financial institutions — the banks and savings and loan companies. Socialism in the United States is still when the corporate jets come down on the Washington airports and the executive passengers disembark in pursuit of government salvation.

In other words, both of the great economic systems, as represented by the Soviet Union and the United States, are in an age not of ideology but of accommodation. And thus my purpose in this lecture. It is, first, to see what circumstances have taken each of the two great systems away from their ideological rules — what problems the two systems have encountered. And then to see what might make the economic prospect brighter for both. No one will be surprised if I concentrate my greatest attention on the capitalist world, and particularly on the still leading industrial power, the one on which I claim competence, namely the United States. But I begin with a comment on the socialist world.

The Soviet economy and, in some measure, the economies of Eastern Europe and China have run into difficulties in these last years, not all of which are different from those being encountered by the United States and the older capitalist countries.

There is, first, the great and still unexplored black hole of all mature economic systems; that is, the tendency of great organizations — of bureaucracy — toward static behavior. Modern economic life, capitalist or socialist, requires massive organization. Only thus can the necessary range of specialized intelligence and experience be brought to bear; only thus can the larger tasks of the modern enterprise be performed and administered. But there is a darker side. All great organization has a tendency to proliferation in personnel and to repetitive sterility in thought. An individual's prestige in organization is measured by the number of his subordinates. He seeks more. And there is stultification of initiative. The mark of wisdom comes to be what most resembles what is already being done. The measure of intelligence is what most clearly reflects established policy. By its nature, great organization, if it does not exclude fresh thought, at least resists it.

In the Soviet Union the state and the enterprise are united in notably massive organization. This is the first and even dominating problem of the Soviet system: a vast and, by the nature of organization, inert, change-resisting bureaucracy. Its principal effect is a static economy. But, as I shall presently observe, this circumstance is by no means confined to Russia or China. It is also a problem of capitalist industry in the older mass-production industries. It is a problem that all industrial countries, not I venture to think excluding Japan, are destined to encounter.

A second difficulty the Soviet Union faces, one less mentioned than bureaucratic rigidity, is the special and growing problem of comprehensive socialism in the modern consumer society. In the world of Lenin and Stalin, consumer wants were few and primitive. The requirements of the new, heavy industrial system brought into being by Stalin were clear and direct. The planned and command structure of socialism was comprehensible and workable.

Not so the modern consumer goods economy. In this economy the products are almost infinitely numerous, of varying styles and designs and in need of many supporting services. And consumer wants change, often with dismaying speed. This is the kind of economy that the Soviet Union and in lesser measure China are impelled by the Western example to have. Success here is the test by which they are judged, by which their own people judge. And for this complex problem in change and response, the command system of the planned economy does not serve. For reflecting consumer wants there is no satisfactory alternative to the market. Only the market informs producers of what consumers want in all its diversity and gains the necessary response.

Further, the Soviet Union, as do the other socialist countries, suffers endemically from inflation. This inflation is manifested in the lines that form at the shops. One of the more reliable of the contrasts between socialism or communism and capitalism is that the first regularly supplies more money than goods and the second recurrently supplies more goods than there is money to buy them.

Finally, the Soviet Union suffers, as does the United States, from a heavy diversion of technical competence, manpower and materials to military purposes. Here consumer taste and diversity do not enter, are not a problem. It is one of the notable facts of our time that the socialist economic system lends itself far better to the planned and command economy of weapons production than to the satisfaction of public wants.

Out of the foregoing circumstances have come the Gorbachev reforms, the restructuring of the Soviet economy — an effort of historic importance. There are three matters central to its success. The first concerns the great bureaucracy, numbering perhaps 30 million people. This vast organization contains many men and women, not unprivileged, who are wholly comfortable with things as they are. And they are not without power. Whether this vast and heavy organization will yield, or can be made to yield, is one of the most important questions affecting the Soviet Union and the world economy today.

The second serious problem facing the Gorbachev reforms is how far it is possible for Russia to go toward the market — toward a system that reflects consumer needs to the producers — without seeming to jeopardize the whole Soviet structure, without arousing the opposition of those deeply attached to the older ideology.

The Soviets have also, as has the West, the need to get inflation and military expenditures under control.

No outsider, and perhaps not many in Russia, can assess the chances for success in this great effort at change. We in the West must, I am certain, wish it well. The world has more to gain from a secure and successful Soviet economy than from an insecure and failing one. Harmony and peace, let us not doubt, go with economic well-being. The Great Depression of the 1930s and its deprivations, we must all remember, was the crucible of war.

I turn now to the capitalist world and to the problems that it faces. These are far from well-defined in our normal economic discourse.

The first of these problems I have already mentioned. The capitalist world must also contend with bureaucratic ossification in its large-scale industry. This affects especially the mass-production industries — steel, ship-building, on frequent occasion automobile manufacture, other mass-production industry — in the older capitalist countries. By the same token, their relative flexibility is the advantage — the temporary advantage, I will hold — of the newer industrial countries, which is to say, Japan, Korea, Taiwan and others of the Pacific Basin, extending on to India and Brazil. Let us, I urge, not be in doubt; the bureaucratic tendency to the ossification of large organization is a basic feature of industrial age.

Bureaucratic rigidity is related, in turn, to a second and dominating feature of advanced economic development. This, too, is a circumstance that deserves far more attention than it receives. I refer to the ineluctable, inescapable movement of industry from older industrialized countries to new. This is the movement that occurred earlier from Britain to Germany and France and on to the United States. And it is the movement that then continued on to Japan, yet on to Korea and the Pacific countries and to Brazil and India.

The foundations of this movement lie partly in the bureaucratic sclerosis in the older countries — the tendency of older mass-production industries to become sclerotic and inefficient. More, however, is to be attributed to the nature of technology and to a great and enduring fact concerning labor supply and the labor force.

As regards technology and production methods, we have only to note that these move across international frontiers — across oceans and desert — with something approaching lightning speed. And they move to the most appealing and advantageous manpower situation. This last is manpower recently rescued from worse and worse-paid toil. To the people so rescued, the harshest urban and industrial pay and existence are regularly a miracle of social and economic improvement over low-paid agriculture. It is not too much to say that industrial success is greatest with such a labor force.

In past times United States industry drew its industrial labor from its own adjacent farms, then from the poor of our Appalachian plateau, then from Eastern Europe and from the descendants of the emancipated slaves. When we ran out of such recruits, our great industries began to languish in competition with those countries that still had an adequate, as Marx would say, reserve army from rural life. This, too, was the fate of Western European industry — a fate partly postponed by recruitment of guest workers, as they are called, from the still impoverished rural masses of North Africa, Portugal, Turkey, Yugoslavia and southern Italy. It is a fate, I venture, that awaits Japan as later generations of urban workers reject industrial toil and as the supply of workers from agriculture is exhausted. The availability of such recently recruited labor is the current success of

Korea and Taiwan. It is the bright industrial future that awaits India and China with their nearly inexhaustible resource in such manpower.

Out of the circumstances just described — economic change, as ever, is a tightly interlocking matrix — comes a further and compelling economic development. That is the drive for tariff protection in the older countries. Once it was the new countries that sought protection for their nascent industry — the infant-industry case for tariffs. Now it is the old and senile industry that seeks protection. So it is in the United States; once having encouraged economic development in the new countries, our industries now seek protection therefrom. So it is also in the EEC, a banding together of European countries no longer in fear of each other's competition but indubitably in fear of that of the newly industrialized lands. To a proper trade policy, as I see it, I will return.

The next of the great problems of modern industrialization is more specialized; it is evident more strongly in the United States and in some of our South American neighbors. It is the *political* asymmetry of economic policy, as now required, and its consequences. This, I do not doubt, requires a word of explanation.

In all of the industrial world since the Keynesian Revolution of the 1930s, governments have assumed responsibility for the overall or macroeconomic performance of their economies. This was, everywhere, the response to the deprivations of the Great Depression. In practical terms, it has meant action by fiscal or monetary policy against the extremes of unemployment or inflation and to assure an acceptable rate of economic growth or expansion.

Of the way the instruments of macroeconomic policy are employed all are aware. Through fiscal action — reduced taxes, higher public expenditure, a deliberate public deficit — government policy is brought to bear to reduce unemployment and encourage economic expansion. And the reverse action is assumed against inflation. Monetary policy, the operative instrument being interest rates, is similarly involved: low interest rates act against unemployment, high interest rates against inflation.

Here the political asymmetry enters. Fiscal policy against underemployment and recession — tax reduction, more public expenditure — is politically attractive. Not, alas, the reverse. Tax increases, reduced public expenditure, are politically unpopular. And monetary policy, invoking what is often assumed to be the magic of the central bank, is politically far more agreeable than fiscal policy. In particular, it is far more agreeable than tax and expenditure constraint as action against inflation.

The result of this political asymmetry, notably in the United States but also in other countries, has been a soft fiscal policy and a relatively astringent, high-interest-rate monetary policy — in practical terms, very large budget deficits with inflation held in check, or so it is hoped, by relatively high real interest rates.

This course of policy, notably the high interest rates, has discouraged private investment — that is what high interest rates are meant to do. And in the United States in the recent past these rates have attracted foreign investment, bid up the dollar, accorded a major subsidy to American imports and placed a heavy penalty on American exports. The further and inescapable result has been an unparalleled trade deficit. All this is recognized, but, surrendering to the asymmetry, politicians now in office — the administration of Mr. Reagan — have contentedly left the solution to their successors. Some of the latter, now aspiring to higher office, go far to promise that they will follow the same course. They promise that taxes will never be raised, that no active fiscal policy will be pursued, that reliance on high real interest rates will continue. To repeat, this is the predictable result of the political asymmetry of the Keynesian economic prescription.

This is a further damaging feature of present policy in the United States and in lesser measure also in Britain. That is the heavy diversion of capital and trained manpower to military purposes. In contrast, other countries, notably West Germany and Japan, out of the lessons of war and defeat, have concentrated their capital and manpower resources on building not military but economic strength. The wisdom of that course is manifestly evident in their success. The commitment to heavy military expenditure must be listed as one of the economically most damaging problems in the United States, as, in lesser measure, elsewhere.

Finally, the capitalist world, especially the English-speaking countries, suffer from an obsolete view of the relation of workers and employers and of employers and the state. The traditional relationship between employer and worker has been rendered extensively obsolete by modern technological change. The man or woman who follows the work of the robots on a computer screen is neither worker nor management. He or she is part of a larger and inescapably cooperative association, one that must eschew the traditional command and response as well as the egregiously different levels of compensation that now exist. Also both cherished and obsolete is the view of the state, which goes back to Adam Smith, as the natural enemy of business enterprise. A cooperative relationship between industry and government on issues ranging from support on technical innovation to provision of necessary industrial infrastructure, as Japan has so ably shown, is now essential.

As I've said, the English-speaking countries have especially lagged; we still relish the Marxian class struggle. In Japan and I assume also in Korea, students also study Marx. However, they accept that the state is not the natural enemy of business but, as Marx held, the executive committee of the capitalist classes. So it is accepted that the state will provide technological and educational support to industry and will anticipate industry's need for infrastructure, resources, trained manpower and even a leadership role by the state on technical and scientific innovation.

The time has now come for a more affirmative view. What can be done to remedy or alleviate the problems for capitalism I have here identified?

The course of policy, if not easy, is, I think, clear. In all the capitalist countries, old and new, we must recognize and accept as normal the tendency to bureaucratic ossification in large-scale industry. Only when this is so recognized will we be on guard against it. No country, old or new, that has large-scale enterprise should be sanguine as to the general tendency of bureaucracies. All must understand and accept it; the measure of modern management must be the ability to resist it.

We must also accept as a fact of capitalism the movement of mass-production industry from the old countries to the new. I do not rise each morning, as do many of my economist colleagues, to make a prayerful obeisance to free markets and free trade. But this movement, now evident for the better part of two centuries, is not something we can or should resist with tariff protection. It means, rather, that the older countries must direct their productive energies to those other enterprises which do not involve mass labor requirements. Advanced technological development reflecting continuing scientific advantage is an obvious and oft-mentioned case, but it is one, as I have noted, that reflects a far from enduring superiority. A stronger case is the industries that call for a higher level of art and design. So are the arts themselves. So also entertainment; no country quite competes with the United States in the production of popular music and morally questionable television. Economic life is not exclusively the production of things; once supplied with physical artifacts, people go on to other enjoyments. It is there, out of a more fully established tradition — modern Italy is perhaps the most striking example — that the future of the older capitalist countries resides. It is from this advantage — from the resulting products of advanced science and technology, of good and innovative design, of the arts, of entertainment, of tourist attraction and of educational opportunity — that these countries must expect to pay for the mass-produced products of the new countries.

It has long been my view that in international trade we should think of agriculture as a special case. Farmers in the industrial countries retain a strong political voice and a powerful traditional claim on public attitudes and policy. And they are determined protectors of their own economic terrain. Accordingly, in all the industrial countries — Japan, the EEC, the United States — farmers are effectively under the protection of the state. I believe, as a practical matter, that that should now be accepted. We will do more for liberal trade in other products if we recognize that farmers are for all countries, as I have said, a uniquely intransigent case.

In the United States we must sooner, not later, come to terms with the political asymmetry of macroeconomic or Keynesian policy. The modern economy and international economic stability require a strong fiscal policy — a willingness to tax as required. And this must be combined with an easy monetary policy allowing of low real interest rates with consequent encouragement to investment and to international currency stability. In the United States we are not close to that goal; we are, indeed, a bad example for the rest of the world. It is possible, though, that there will be a turn for the better. The next election will see the disappearance of an unduly amiable president, one for whom the script is, by long theatrical training, a substitute for reality. Thus the prospect for a turn for the better.

A source of hope as regards fiscal policy as well as for the greatly larger prospect for survival itself is the improved relations between the Soviet Union and the United States. Modern technology, the threat of nuclear war in particular, has brought both of the superpowers to the same side of the table facing the common threat of nuclear devastation. This neither economic system, both of them highly sophisticated, would survive. At the same time, there has been a declining fear of socialism in the capitalist world as this system has encountered and confessed its difficulties. And, as I have noted, in the socialist world fear of capitalism has now given way to a consideration of what concessions socialism can make to the market.

A reduction in military expenditure would be a shared benefit of major proportions to both the United States and the USSR.

Finally, I would like to see, especially in the English-speaking countries, a more cooperative association between industry and government and, likewise, between industry and workers. The gains from intelligent association and cooperation are great; the costs of conflict we have already seen to be heavy. This chapter of the economic history of capitalism, tracing to Adam Smith and still articulated as an article of belief by many American conservatives, must now be closed.

There is more that could be added to the capitalist, or perhaps I should now say the nonsocialist, agenda. In the United States and in lesser measure elsewhere in the industrial world the differences in economic and social well-being are far too great. Our central cities are deprived and disordered and a threat to political tranquillity. There is the problem of Third World debt — debt that has impaired economic development and well-being for too long. This must be excised in the interest of all. And there are the problems of the Third World itself. They are a further and even larger chapter in the economic and social history of our time.

But now I must bring this lecture to a close. I come back to the two great systems. The agenda for capitalism is not less than that for socialism. Perhaps, on balance, it offers an easier path. We should be no less urgent in pursuing it.