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THE COMPATIBILITY OF STABLE PRICES, FULL EMPLOYMENT AND FREEDOM

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Human wants are unlimited while the resources for satisfying those wants are limited. If it were not for this elementary fact there would be no need to economize, nor for the study of economics, nor for economists. And men do not live by bread alone. We as men have other goals. Often these goals are expensive in terms of each other. Frequently, we can not achieve one goal in greater measure without settling for achieving another goal in lesser measure. All too often we fail to face up to this fact. This is at the root of our recent problems in trying to achieve full employment and stable prices at the same time.

Before pursuing these thoughts further some definitions are in order. Full employment does not mean literally that 100% of the working force is employed. This would be impossible except in a completely totalitarian state. There is always in a free economy or semi-free economy a few hundred thousands of unemployed persons who are in the work force. They include persons who have quit their former jobs or were fired or laid off and have not yet found a new job and young persons who have just entered the work force and have not yet found their first jobs—among others. This type of unemployment is called frictional unemployment. This type of unemployment most Americans, I am sure, would want always to be with us—provided they understand what is involved. To be rid of frictional unemployment is to be rid of freedom. All economists interpret full employment to mean high level employment and perhaps the vast majority would accept the following definition: full employment means that 95% to 96% of those willing and able to work are employed. A few, the conservatives, would prefer a lower percentage as the definition of full employment, say 93%. A few, the liberals, would prefer a higher percentage, say 97% or even 98%. Most economists would agree that 98% (and maybe 97%) is too high—too high in the sense that we "can't" have this full employment without inflation. On the other hand perhaps most economists would say that 93% is too low—too low in the sense that society would then be doing without the production of some 2 million persons who are left without employment aside from those frictionally unemployed. Full employment will be defined here as the situation wherein 95% to 96% of the working force is employed.

Stable prices does not mean completely stable prices for that too is impossible except in a completely totalitarian state—and inadvisable even there. Neither does it mean that the prices of individual goods and services are stable—rather that individual prices fluctuate in such a way that the weighted average of prices is stable—i.e., the consumers' price index is stable. In a dynamic economy the prices of goods the demand for which is declining relative to the supply do and should fall. And the prices of goods the demand for which is increasing relative to supply do and should rise. This is the free economy's signal to producers to reduce the output of the former and to increase the output of the latter. People want less of the former and more of the latter. But we still have to define what is meant by stable prices. Stable prices are defined as a condition in which prices as a whole fluctuate within a narrow range—say 1 or 2%. Individual prices would be free to fluctuate much more widely than this. Prices as a whole, the price levels, in the past have fluctuated much more widely than this. I am quite sure that every economist would agree that if price fluctuations could be held within 1% of some base that we would have achieved very stable prices. Some would settle for 2% or even more and some would accept a trend of let us say an increase of 1 to 2% a year as tolerable. Here we will define stable prices as the situation in which the price level is allowed to fluctuate up or down but not more than 1 or 2% in a given year nor up more than 1% per year in the event of an upward trend (which, like the poor, I fear we will always have with us).

The definition of freedom presents some problems. Freedom in general is a rather empty concept unless we restrict some individual freedoms. The most ardent freedom lovers (provided they are rational) would grant this. For example, the freedom of men to use the streets and the highways is not of much value if individual men are permitted to use the streets as they please. So we restrict speed, bar driving on the left side of the road, ban tractors with lugs, and the like. These restrictions on freedom surely enhance the freedom of people as a whole. I am willing to forego the freedom of driving 100 miles per hour down residential streets in order to take that freedom away from others. In the process your freedom and mine become more meaningful. For convenience of exposition, I will defer further discussion of freedom at this point except to say that the people as a whole seem to accept whatever freedom we have at the moment as the ideal. We appear to want to keep the institutions we have and the individual freedoms we have whatever the implications for freedom as a whole. Freedom is thus tentatively defined here to mean the maintenance of our institutions and freedom as they are.

Given the public's propensity to maintain our institutions and freedoms as they are, can we have 95% to 96% of the working force employed and keep price increases to the level indicated above?

There is a consensus that *most* people want both full employment and stable prices in some sense, at least, if not in the above sense. However, some people do not want employment this full in the belief that it makes for too rapid wage increases or undisciplinable workers or both. Some people do not want prices this stable. Those who have volatile incomes prefer inflation since their incomes rise more rapidly than prices do. Those who have relatively stable incomes prefer no price increases at all or better still price decreases. Those who have retired on savings prefer deflation since it makes their saved dollars go further. So we find that while most people want both full employment and stable prices, there is no unanimity. We will deal here with the assumed majority which wants both full employment and stable prices.

But full employment and stable prices are not the only things that this majority wants. They want these among other things and sadly most of them do not know, or appear not to know, that the things they want are often costly in terms of each other.

Economics deals with allocating scarce means among competing ends in such a way as to maximize satisfaction. The means are limited but the ends are not. Analysis of how the means can be most efficiently used to achieve the ends society selects is the economists' business. The choice of the ends is society's business. As a member of society, the economist has his vote which he uses as just another member of society—not as an economist. It is the economists' privilege and duty to point out why society can not (usually) have more of one thing, say X, that it wants without sacrificing something else, say Y, that it also wants—and how much of Y must be sacrificed to get a given increase of X. If a fully employed society spent all of its income on X, Y, and Z, it can get more of both X and Y but in this case it will have to settle for less Z. All too often people want more of X, Y, and Z, without realizing that each is costly in terms of the other two.

One of my colleagues expresses the idea very well in an uneasy triangle faced by students. They want education, social life, and work to support the first two. They want more of all three but they can get more of one only by sacrificing at least one of the other two. Social life and work are often increased to the detriment of education. They pay for more social life and work both of which they want at the expense of education which presumably they also want—but with less intensity.

We want full employment and stable prices and we also want to keep the institutional framework in which our economy operates. This institutional framework consists of such things as free collective bargaining on wages (i.e. without interference by government), freedom of sellers to increase their prices if they want to (without interference), etc. Again, we have an uneasy triangle. We as a people appear to want full employment, stable prices, and the maintenance of our institutions as they are. Often we cannot have more of any one of them without settling for less of at least one of the others. We cannot have full employment and stable prices which we do not have without giving up something else which we also want. Too many people have not and are not facing up to this fact.

If there is less than full employment, government can and does take steps to increase employment. Such steps include making money plentiful and easy to borrow, cutting taxes, and/or increasing its expenditures. But these things make it easier for sellers to raise their prices which they proceed to do. We pay for full employment with inflation, i.e. by sacrificing price stability. If, on the other hand, we have full employment and prices are rising, government can take steps to check the inflation. Such steps include making money tight and hard to borrow, raising taxes, and/or reducing its expenditures. But these things make it harder for sellers to sell capacity output at prices that they like so they reduce output and lay off people; we pay for stable prices with unemployment, i.e., by sacrificing full employment.

There have been brief periods in our history during which we enjoyed full employment and stable prices at the same time but they have been fortunate accidents and short lived. Whenever we have had sustained full employment for any length of time, we have also had inflation. Is there any way out of this dilemma? Yes! But maybe we are not willing to pay the price. We can have both full employment and stable prices provided we are willing to reduce the freedom of Big Labor and Big Business to price their services and products as they please. Similarly we can keep our institutions and freedoms as they are and full employment if we are willing to pay for them with inflation or we can keep these institutions and stable prices if we are willing to pay for them with unemployment. Some economists have suggested that we try to keep all three recognizing that we cannot have any one to the nth degree; i.e. settle for a little less full employment, a little inflation, and a little modification of our institutions.

Some months ago a group of economists testified before a congressional committee relative to this uneasy triangle. Among the economists who testified were one from Case Institute, one from the University of Chicago, and one from Harvard. One suggested that we as a people attach too much importance to full employment—that we settle for a little more unemployment in order to avoid sacrificing either of the other two wants. The second suggested that we attach too much importance to stable prices—that a little inflation was a small price to pay for full employment. The third suggested that we keep both full employment and stable prices and restrict Big Labor and Big Business. All three are competent economists who analyzed the problem in the same manner. The divergence in their policy proposals was born not of their economics but of the differences in the intensities of their wants.

We can have full employment and stable prices at the same time. This is an economic fact. We would have to modify the framework in which the economy operates to achieve these two goals. As an economist I cannot say whether we should do this. But I can say that it can be done.

Arthur Burns, the ex-Chairman of the President's Council of Economic Advisors and Professor of Economics at Columbia and President of the National Bureau of Economic Research (the outstanding economics research organization in the United States if not in the world), recommended last October according to the Wall Street Journal that we have sterner enforcement of anti-trust laws which apply to Big

Labor as well as Big Business. With this recommendation I concur. But Mr. Burns was not speaking as an economist except in so far as the implication is there that he knows we could not have full employment and stable prices without it.

Suppose we consider the consequences of following Prof. Burns' suggestion. It would reduce the freedom of labor to drive up wages and the freedom of businesses with monopoly power to mark up prices. Surely they would then have less freedom than they had before but the freedom of the rest of us would be enhanced. Some would lose the freedom to exploit and others would gain the freedom not to be exploited. Many people, if not most of them, would consider this an enhancement of freedom if they understand the problem. Others would disagree whether or not they understood the problem.

In conclusion it can be fairly said that we can have full employment and stable prices at the same time. Depending on one's definition of freedom, we would have to pay for it with less freedom *or* we could have more freedom at the same time.