

## DO WE WANT A CHRISTIAN ECONOMICS? THE U.S. BISHOPS' PASTORAL LETTER

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**M**Y SUBJECT is the pastoral letter *Economic Justice for All*. Many readers may feel, as I do, that the letter generated some discussion about economic-justice issues at the time of its initial drafting and shortly thereafter, but that it has failed as a basis for sustained discussion and U.S. economic reform.<sup>1</sup> This is a tragedy, given the seriousness of the issues involved in economic justice. Furthermore, market-oriented economies seem to be spreading now around the world, and this makes the failure to generate such a discussion particularly worrisome.

In the area of policy, the pastoral generally adopted a Keynesian perspective (I will show this later) and made little attempt to hide this. As a consequence, Keynesians found an ally and non-Keynesians did not. Economists such as Milton Friedman responded in a very critical way to the pastoral, while other economists such as James Tobin reacted more favorably. It is no coincidence that, as we shall see, these two men belong to different schools of economic thought within the science of economics. So, the battle lines seemed drawn and the bishops speak as (just) another voice with particular interests in a pluralistic world. Unfortunately, this approach alienates many and comforts many while challenging few. It would seem more ideal to neither comfort nor alienate, but to hold all sides accountable for human values. A challenge may be understood as a call to creativity, and the pastoral was not such a successful call.

To generate such discussion about justice, it may be necessary to take a somewhat different, more even-handed approach to economic theory than what was taken in the bishops' letter. It seems necessary to appreciate and deal with the pluralism in economic science and its implications if there is ever to be sustained discussion among economists. Not all serious Christians need be Keynesians, any more than all serious Christians must be socialist. I shall illustrate a pluralist approach which I believe is more likely to be fruitful as a basis for sustained discussion and U.S. economic reform and is actually more consistent with the understanding and appreciation of scientific pluralism which the Church

<sup>1</sup> The Church itself was also targeted for reform in the letter, but I am unaware of any sustained systematic effort in this regard.

has developed in recent times.<sup>2</sup> It seems that, on the basis of theological ethics, none of the schools of economic thought can be declared uniquely Christian in our time (for the most part, the differences must be resolved by economists on the basis of empirical work); therefore it will be necessary to accept this pluralism.

To illustrate my approach (which would not opt for a specific school of economics), I shall use the issue of full employment. This seems to be a good choice since, according to the bishops, it is the very foundation of a just economy. I shall review what the bishops and several of their more important commentators have had to say about full employment, then review the various schools of economic thought on the subject without limiting myself to Keynesian economics. After this I shall move to the most interesting task of teasing out the implications of this review for social ethics. An episcopal acknowledgment of the other schools would have opened up an entirely different world of options and might have challenged economic thinking in general to respond freely to human values within their own economic models. It is quite conceivable that creative position papers on how to implement the basic principles in the pastoral would still be debated today in a healthy way, had the principles not been tied to a particular economic school of thought.

#### ECONOMIC JUSTICE FOR ALL

In the pastoral full employment is said to be *the* very foundation of a just economy:

Full employment is the foundation of a just economy. The most urgent priority for domestic economic policy is the creation of new jobs with adequate pay and decent working conditions. We must make it possible as a nation for everyone who is seeking a job to find employment within a reasonable amount of time. Our emphasis on this goal is based on the conviction that human work has a special dignity and is a key to achieving justice in society.<sup>3</sup>

Because the very foundation of a just economy is full employment, the most urgent priority for domestic economic policy is the creation of new jobs. The bishops lament that the unemployment rate has generally drifted upward since World War II, when it reached a low of 1.2%. Current rates of unemployment are clearly unacceptable.

The letter is specific with respect to two types of policy approaches that should be used as tools to bring about full employment. Most

<sup>2</sup> In *Sollicitudo rei socialis* the Church is seen as an "expert in humanity" (par. 41), and she offers no technical programs. The Church does not offer a third way between capitalism and communism, e.g., but forces both to account for themselves in terms of certain values.

<sup>3</sup> United States Catholic Conference, *Economic Justice for All* (Washington, D.C.: United States Catholic Conference, 1986) par. 136.

importantly, the “general or macroeconomic policies of the federal government,” which include fiscal and monetary policies, must be used even at the risk of inflation,<sup>4</sup> and “specific programs and policies targeted toward particular aspects of the unemployment problem” must also be adopted to supplement fiscal and monetary policies. The bishops state it this way:

The general or macroeconomic policies of the federal government are essential tools for encouraging the steady economic growth that produces more and better jobs in the economy. We recommend that fiscal and monetary policies of the nation—such as federal spending tax, and interest rate policies—should be coordinated so as to achieve the goal of full employment.

General economic policies that attempt to expand employment must also deal with the problem of inflation. The risk of inflationary pressures resulting from such expansionary policies is very real. Our response to this risk, however, must not be to abandon the goal of full employment, but to develop effective policies that keep inflation under control.

While economic growth is an important and necessary condition for the reduction of unemployment, it is not sufficient in and of itself. In order to work for full employment and restrain inflation, it is also necessary to adopt more specific programs and policies targeted toward particular aspects of the unemployment problem.<sup>5</sup>

These are examples of the policy recommendations which place the bishops so clearly in the Keynesian camp.

The earlier two drafts of the pastoral also took a Keynesian stance, but these drafts were even more bold and specific concerning what the bishops understood (or at least what they thought they understood at the time) about economics and the U.S. economy. The first draft actually went so far as to specify numerically what the maximum unemployment rate in the U.S. should be:

We believe that an unemployment rate in the range of 3 percent or 4 percent is a reasonable definition of full employment in the United States today. We have noted above that considerably higher rates have received growing public and professional acceptance in recent years for a number of reasons. . . . Toleration

<sup>4</sup> Economists have long pointed out that price inflation has many consequences, especially if it is unexpected. E.g., price inflation tends to redistribute real income (purchasing power) rather arbitrarily from those living on fixed incomes and from savers to debtors. Inflation makes planning difficult for businesses, households, and government, and for this reason may be a source of conservatism on the part of business. This would tend to restrict the creation of new jobs. Psychologists also point out that an inflationary atmosphere often contributes to personal instability.

<sup>5</sup> *Economic Justice for All*, par. 156–58.

of present unemployment rates would have been unthinkable 20 years ago. It should be regarded as unacceptable today.<sup>6</sup>

The second and third (final) versions of the letter do not numerically specify what the maximum unemployment rate in the U.S. should be. However, the bishops continue to reject current unemployment rates and they recall with favor the lower unemployment rates that existed during World War II. This process of revision allows a greater role for empirical work in economics in setting employment targets. The bishops choose to retreat from such specifics, and this forces us to consider the methodological question of how moral inquiry might relate to economic thought with regard to setting and achieving important goals. The process seems to show an appreciation that too much specificity on the part of the bishops might lead to mistakes and perhaps to excessively favoring some economic theorists over others.

In fact, economists who criticized the pastoral did so generally in the form of an attack on the means, not the ends, contained in the letter. In an article entitled "Good Ends, Bad Means,"<sup>7</sup> Milton Friedman labeled the bishops' objectives as "highly commendable" and ones which "every person of goodwill accepts."<sup>8</sup> The means, however, are "warmed-over proposals that have been discredited by experience."<sup>9</sup> What is conspicuously absent in this article, and other such articles by Friedman, is a discussion about how to achieve the objectives. It seems to me that the bishops have never really put the question to this (Nobel Prize-winning) economist of how he thinks the U.S. might make an option for the poor in its economic life. In his economic analysis Friedman simply cannot accept a Keynesian framework (and there is at this point no compelling reason why he should), and unfortunately the pastoral is firmly wedded to the analysis that he has spent a lifetime refuting. In the case of Friedman, it seems that he should be encouraged to offer solutions within the context of his economic models. Indeed, since he has given such an endorsement of the "ends" of the pastoral, it seems incumbent upon him to demonstrate such solutions undistracted by a Keynesian framework. The adoption of a Keynesian program by the bishops can become an excuse for some not to pursue the ends.

The adoption of a Keynesian perspective has reduced the creative

<sup>6</sup> First draft, "Catholic Social Teaching and the U.S. Economy," *Origins*, Nov. 15, 1984, par. 179.

<sup>7</sup> Milton Friedman, "Good Ends, Bad Means," in Thomas Gannon, S.J., ed., *The Catholic Challenge to the American Economy* (New York: Macmillan, 1987) 99-106.

<sup>8</sup> *Ibid.* 99.

<sup>9</sup> *Ibid.* 100.

impetus of the letter in other ways also. As their first strategy to combat unemployment, the bishops advocate that fiscal and monetary policies of the nation should be co-ordinated so as to achieve the goal of full employment even at the risk of inflation. However, there are strategies to reduce unemployment that are quite tangential to the Keynesian-monetarist debate and which receive insufficient attention with the bishops' reliance on traditional Keynesian measures. Let me mention an excellent example of this.

A very significant proposal to reduce unemployment has been made by Martin Weitzman of M.I.T. in *The Share Economy*,<sup>10</sup> and the bishops do not mention it in connection with the goal of full employment. This proposal has received widespread attention within economics.<sup>11</sup> The primary argument Weitzman makes is that through a change in the structure of employee compensation it would be possible to bring about higher levels of output and employment without inflation than what we experience under the current structure of employee compensation. Our macroeconomic problems may be remedied by certain actions taken at the microeconomic level. High unemployment can be remedied at least in part by indexing wages to employer profits. According to Weitzman, the current wage system is inadequate in the war against simultaneous unemployment and inflation (stagflation), while an economy in which wages depended on profits would not be subject to the stagflation malady. Weitzman summarizes his thesis in this way:

The thesis of this book is simple. A basic change in employee-compensation arrangements is required to assure that reasonable price stability is compatible with reasonably full employment. So long as we persist in restricting policy options to the usual measures of aggregate fiscal and monetary policy, we will not be able to conquer stagflation. That task is well beyond the range of conventional tools of macroeconomic management.<sup>12</sup>

I shall not enter into the details of Weitzman's theory here, except to say that he has a viable program to reduce unemployment (in a noninflationary way) that has yet to be tried. In fact, for Weitzman the preoccupation in public policy and in the economics profession with Keynesian economics holds us back from meeting contemporary economic chal-

<sup>10</sup>Martin L. Weitzman, *The Share Economy: Conquering Stagflation* (Cambridge, Mass.: Harvard University, 1984).

<sup>11</sup>The share economy has been the subject of many recent articles. A good place to begin a study of the literature would be William Nordhaus and Andrew John, eds., "The Share Economy: A Symposium," *Journal of Comparative Economics* 10 (1986) 414-73.

<sup>12</sup>Weitzman, *The Share Economy* 2.

lenges.<sup>13</sup> Weitzman's idea has been called "the best since Keynes,"<sup>14</sup> but the pastoral seems more concerned with much less creative ideas that have dominated the past.

In a generally sympathetic article Bruce Douglass<sup>15</sup> writes that the pastoral rests on a defensible foundation. He says that although economic liberalism has been conducive to liberty and has been extraordinarily conducive to productivity in the economic sphere, liberalism has had a significant price. Economic liberalism militates against social justice and community, and it attends only to the material side of human existence. Yet Douglass offers three criticisms of the pastoral:

1. The reliance on scripture may not be adequate for the purposes of moral and political philosophy.
2. The document does not recognize the likely incompatibility between economic efficiency/prosperity and the virtuous life as conceived in Catholic thought.
3. The document contains a dated concept about the role and limitations of the modern state.

What is said in the third criticism concerns us here. Douglass states:

Even though it [the pastoral] speaks eloquently in the introductory paragraphs of the need for theological reflection to be sensitive to "the signs of the times" and in so doing acknowledges the novelty of this particular moment in American economic history, most of its discussion of particular economic issues reads like

<sup>13</sup> For readers more technically inclined in economics, Weitzman sees Keynes's solution as a digression from the real problem, which is the downward inflexibility of nominal (money) wages. Thanks to Keynes, discussion among economists about the level of nominal wages had been replaced by discussion about discretionary fiscal policy. Today, however, it is necessary to implement structural changes in the manner in which labor is paid if the problems of American capitalism are to be confronted successfully: "The effect of the Keynesian critique was profound. Pigou himself conceded as much when he wrote, a year after *The General Theory*: 'Until recently no economist doubted that an all-around reduction in the rate of money wages might be expected to increase, and an all-around enhancement to diminish, the volume of employment.' Like a great magician, Keynes removed the wage issue from center stage and replaced it by discretionary government policy to manage aggregate demand. In the long course of history I think this disappearing act must increasingly come to be viewed as something of a dazzling digression from the main route to economic prosperity. Detours are necessary, of course, when the primary road is impassable (and, let us hope, being repaired). But no matter how rough and intractable it may appear at first glance, sooner or later the wage issue must be confronted head on. How labor is paid remains the central issue. And in our time stagflation has returned it to center stage with a vengeance" (54).

<sup>14</sup> *New York Times*, March 28, 1985.

<sup>15</sup> R. Bruce Douglass, "First Things First: The Letter and the Common Good Tradition," in *The Deeper Meaning of Economic Life*, ed. R. Bruce Douglass (Washington, D.C.: Georgetown University, 1986) 21-36.

similar pronouncements of twenty, thirty and even fifty years ago. . . . The letter badly needs an infusion of sophistication about the complexities of social policy today. . . . In this setting the bishops can ill afford to appear as well-meaning dogmatists who cannot bring themselves to give up outworn clichés.<sup>16</sup>

Keynes published his *General Theory of Employment, Interest and Money* in 1936, over 50 years ago. Douglass sees the need for creative new strategies and for a questioning of dated solutions to economic problems. Such new strategies are found in dialogue with those who have special knowledge about the complexities of social policy; the strategies are not found in clichés.

William Byron, certainly very sympathetic to the pastoral and its message, has also noted the need for new and creative solutions to the problem of unemployment:

Yet another quality could be said to be essential for the successful implementation of this letter—creativity. Call it a virtue or any other name, but be assured that without creativity, the bishops' letter would remain merely a lengthy epistle; it would not be an occasion of social reform that benefits the poor and the unemployed. Creative implementation is imperative.<sup>17</sup>

Although the pastoral contains policy recommendations, Byron does not find new and creative policy recommendations therein; on this he and Friedman agree. Byron calls on experts to develop programs to achieve the bishops' goals. Unlike Friedman, he endorses the list of five categories contained in the pastoral letter of possible topics to which the experts should address themselves: employment and unemployment, poverty, food and agriculture, the U.S. and the world economy, and the new American experiment.

If our goal is to have informed ethical reasoning on unemployment, we must hear those who have special knowledge about the complexities of social policy. Many economists warn us that the trade-off between unemployment and inflation is much more complicated and less favorable than what the bishops indicate in even the final draft. To understand the limitations of expansionary policy, it is necessary to review in a basic way the economic background to this issue. The following review of the schools of economic thought will allow us to see some of the shortcomings in the current approach and the shape of things in the pluralist approach. We shall see that this Keynesian perspective has steered the bishops out of their sphere of competence; it has allowed them to make severe technical/economic errors concerning the limits of monetary and fiscal

<sup>16</sup> *Ibid.* 34–35.

<sup>17</sup> William Byron, S.J., "The Bishops' Letter and Everyday Life," in Gannon, *The Catholic Challenge* 249.

policy; and, most importantly, it has subliminally declared a Christian economics which can only stifle debate.

#### ECONOMIC BACKGROUND

##### *The Keynesian Revolution*

The greatest economist of this century was John Maynard Keynes. All serious economic analysis today is at least informed by his work, and in that sense all economists are Keynesians. His great contribution to economic thought was this: capitalism is not necessarily a system that would stabilize at a level consistent with full employment of its resources, particularly in the short run. He stressed the instability of capitalism and criticized the complacency of the classical economists. Although his theory criticized the system "from inside," he seems to show at least implicit awareness of the Marxist critique.<sup>18</sup> Of course, it must be remembered that he wrote during the Great Depression.

The classical economists (before Keynes) had stressed the self-adjusting tendencies of a market economy. They had also stressed that real factors determine real variables; output and employment are primarily functions of population, technology, and the capital stock. It was generally believed that the economy would stabilize at a level consistent with full employment of these resources in both the short and long run; there would be little cyclical unemployment.<sup>19</sup>

Keynes believed that the system could actually stabilize at a level of output and employment that entails massive unemployment. Demand factors, not simply supply factors, determine the levels of output and, most importantly, employment. His theory led to much more activist policies on the part of government. He showed that government could and should confidently take an active role in the economy. This conflicted sharply with the classical *laissez-faire* approach. Furthermore, Keynes's theories led to the use of government economic influence to accomplish other social goals such as greater equity in the distribution of income, engineering for greater social security, and other goals of this type.

<sup>18</sup> It is interesting to note that "classical economists" was a term created by Marx. Keynes adopted the term and gave it currency within orthodox economic analysis.

<sup>19</sup> Economists distinguish between three types of unemployment. There is "frictional unemployment," which refers to people who have voluntarily quit their jobs in hopes of greener pastures elsewhere and are therefore temporarily between jobs. There is "structural unemployment" in those cases where workers do not have marketable skills and can find no work for this reason. The causes here may be automation, a change in the structure of demand, or similar reasons. Finally, there is "cyclical unemployment," which refers to those who are unemployed or laid off without work because of a downturn in the business cycle. When economists speak of "full employment," they mean that rate of unemployment which would exist only when the third component of unemployment, cyclical unemployment, is zero.



Keynesian theory led the federal government down the path of aggregate-demand management. Aggregate demand should be stimulated until full employment is reached. Inflationary pressures were not expected until full employment was reached, at which time increased aggregate demand could only bid up prices. Full employment was the inflation threshold. It was a cause for considerable alarm when in the 1950s inflation was experienced *before* full employment was reached. Inflation and significant unemployment existed simultaneously, and economists were forced to grapple with this paradox.

#### *A. W. Phillips*

The modern economic discussion about the trade-off between unemployment and price inflation may be traced to a 1958 article by A. W. Phillips.<sup>20</sup> In fact, the graphical representation of this trade-off is commonly called a "Phillips curve." Phillips describes the purpose of his study in this way:

The purpose of the present study is to see whether statistical evidence supports the hypothesis that the rate of change of money wage rates in the United Kingdom can be explained by the level of unemployment and the rate of change of unemployment, except in or immediately after those years in which there was a very rapid rise in import prices, and if so to form some quantitative estimate of the relation between unemployment and the rate of change of money wage rates.<sup>21</sup>

Phillips found that historical data did reveal evidence of an inverse relationship between the rate of change of money wages and the level of unemployment. This essential finding is illustrated in the graph on the next page, which is reproduced from his work.<sup>22</sup>

Phillips estimated the above curve, which passes through the points on his scatter diagram, with a logarithmic equation using the least-squares method.<sup>23</sup> Clearly, some points deviate significantly from his estimated curve. The deviations were found to have two causes. The rate of change of money wages tended to be higher during the upswing of the business cycle, and lower during the downswing of the business cycle. So, points which lie above the curve tend to correspond to years in which the British economy was expanding (and unemployment decreasing), while points below the curve tend to correspond to contractionary periods.

<sup>20</sup> A. W. Phillips, "The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861-1957," *Economica* 25 (1958) 283-99.

<sup>21</sup> *Ibid.* 284.

<sup>22</sup> *Ibid.* 285.

<sup>23</sup> The equation of his fitted curve is:  $\log(Y+.9) = .984 - 1.394 * \log X$ . Y refers to the rate of change of money wages, and X is the unemployment percentage.



Figure 1

The second cause of the deviations from the curve reflects the impact that a large rise in the prices of imported goods can have on the general price level and therefore on cost-of-living adjustments in wage rates. A rapid rise in the prices of imported goods leads to a greater increase in wage rates than would normally be expected to be the case.

For the United Kingdom, stable wage rates would correspond to an unemployment rate of about 5.5 percent. If we assume that wages and productivity expand by 2 percent per annum and we have stable prices, then the associated level of unemployment is about 2.5 percent.

From the perspective of economic policy, the conclusion that may be drawn from Phillips' work is that it is impossible to lower both wage inflation and unemployment. On the other hand, rather convincing evidence has been presented by Phillips that wage inflation and increasing unemployment were also unlikely pairs. Rising aggregate demand was likely to result in a greater rate of increase in money wages and lower unemployment, while falling aggregate demand was likely to result in a lower rate of increase in money wages and higher unemployment. That this trade-off exists is fairly clear. Why it exists is a matter of dispute even today. James Tobin has called the Phillips curve an "empirical finding in search of a theory."<sup>24</sup>

<sup>24</sup> James Tobin, "Inflation and Unemployment," *American Economic Review* 62 (1972) 9.

*Paul A. Samuelson and Robert Solow*

Paul Samuelson, the winner of the first Nobel Prize in economics, has been a dominant figure in economics over the past 40 years. Robert Solow, also a winner of a Nobel Prize in economics, has served as senior staff economist on the Council of Economic Advisers. These men have made important contributions in the debate about the relationship between unemployment and inflation.

It was stated above that modern economic discussion about the trade-off between unemployment and price inflation may be traced to the English economist Phillips and that a graphical representation of this trade-off is commonly called a "Phillips curve." In a significant 1960 article written jointly by Samuelson and Solow, a Phillips curve based on the economic experience of the U.S. was developed.<sup>25</sup> Samuelson and Solow chose to modify their curve by showing the average price rise (per annum) on the vertical axis instead of the rate of change of money wages, as was done by Phillips. This transformation is accomplished by two implicit assumptions of Samuelson and Solow: (1) price changes will reflect wage changes, and (2) wage increases equal to productivity increases, which tend to be at about 2 to 3 percent per year, correspond to a stable price level. Therefore the stable-price-level point of Samuelson and Solow corresponds to the 2 to 3 percent rise in money-wages point in Phillips.

According to Samuelson and Solow, the relationship between inflation and unemployment may be described in this way:

1. In order to have wages increase at no more than the 2.5 per cent per annum characteristic of our productivity growth, the American economy would seem on the basis of twentieth-century and postwar experience to have to undergo something like 5 to 6 per cent of the civilian labor force's being unemployed. That much unemployment would appear to be the cost of price stability in the years immediately ahead.
2. In order to achieve the nonperfectionist's goal of high enough output to give us no more than 3 per cent unemployment, the price index might have to rise by as much as 4 to 5 per cent per year. That much price rise would seem to be the necessary cost of high employment and production in the years immediately ahead.<sup>26</sup>

So, it might be possible to "fine tune" the economy to 3 percent

<sup>25</sup> Paul Samuelson and Robert Solow, "Problem of Achieving and Maintaining a Stable Price Level," *American Economic Review* 50 (1960) 177-94.

<sup>26</sup> *Ibid.* 192.

unemployment at the cost of 4 to 5 percent inflation per year. A Phillips curve according to these assumptions is plotted in the figure below.

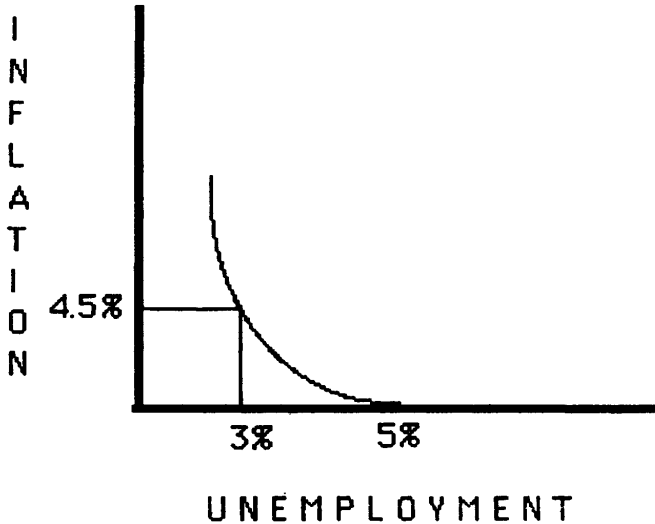


Figure 2

Samuelson and Solow have done for the U.S. experience what Phillips did for the United Kingdom. However, they tend to put even more stress on the care which must be taken in the interpretation of their conclusions:

Aside from the usual warning that these are simply our best guesses we must give another caution. All of our discussion has been phrased in short-run terms, dealing with what might happen in the next few years. . . . What we do in a policy way during the next few years might cause it to shift in a definite way. . . . We have not here entered upon the important question of what feasible institutional reforms might be introduced to lessen the degree of disharmony between full employment and price stability.<sup>27</sup>

As later work has shown, Samuelson and Solow did well to point out the possibility of institutional reform and to distinguish between the long and short run.

#### *Milton Friedman*

Friedman is a leading proponent of the monetarist school of macroeconomic thought. If the Keynesian system was virtually the antithesis of the classical system, the monetarist theories may be understood largely

<sup>27</sup> Ibid. 193-94.

as a restatement of the original classical position.<sup>28</sup> The classical economists stressed the self-adjusting tendencies of a market economy. They believed that the economy would stabilize at a level consistent with full employment of these resources in both the short and long run. The monetarist does, however, admit to *short-run* fluctuations in levels of output and employment, while the long-run levels remain supply-side determined (i.e., a function of population, technology, and the capital stock).

The data lead monetarists to the conclusion that fiscal policy (government taxation and expenditures activity) has little effect on the level of economic activity. Monetary policy (changes in the money supply) is the dominant factor causing fluctuations in output and employment. Although monetary policy is effective, the monetarists do not advocate its use in the pursuit of stabilization goals, as this would just introduce another source of instability into the system. Monetarists are noninterventionists. It is better to create a *stable* environment for the price system than to attempt to smooth out all fluctuations in level of economic activity. Our understanding of the economy and ability to execute policy do not warrant confidence that we can successfully smooth out the business cycle. Their recommendation is to allow constant growth in the money supply, with no allowance for economic shocks. Where there has been excessive growth in the supply of money and therefore inflation, the appropriate remedy is monetary restraint and (temporarily) high unemployment rates.

A significant contribution to the understanding of the relationship between the level of unemployment and the rate of change in the price level was offered by Friedman in a presidential address delivered at the 80th annual meeting of the American Economic Association in December 1967. Friedman argued that monetary policy cannot peg the rate of unemployment for more than a limited time. The delayed consequences of stimulating aggregate demand through monetary policy will offset the favorable short-run effects. This tends to refute that interpretation of the Phillips curve which sees the curve as a locus of sustainable points among which policymakers may choose for the economy.

Friedman argued that there is a "natural rate of unemployment" in the economy which has its source in the structures and the characteristics of economic institutions<sup>29</sup> and is consistent with zero inflation. Policy-

<sup>28</sup>Milton Friedman, "The Role of Monetary Policy," *American Economic Review* 58 (1968) 1-17.

<sup>29</sup>Friedman is quick to point out that by the use of the word "natural" he does not wish to imply any immutability to the natural rate: structural change might indeed be able to lower this natural rate.

makers (or ethicists) may find this natural rate of unemployment to be unacceptably high, and to gain short-run relief (only) they might then pursue expansionary monetary policy to increase aggregate demand and reduce unemployment at the cost of inflation. Total unemployment is reduced primarily by reducing the frictional component. With higher product prices and stable wages in the short run, businesses will experience increased profits and will tend to expand output and employment. This much is standard orthodoxy and is consistent with the existence of the Phillips curve. In terms of the graph below, we may interpret this as a movement from point A to B.

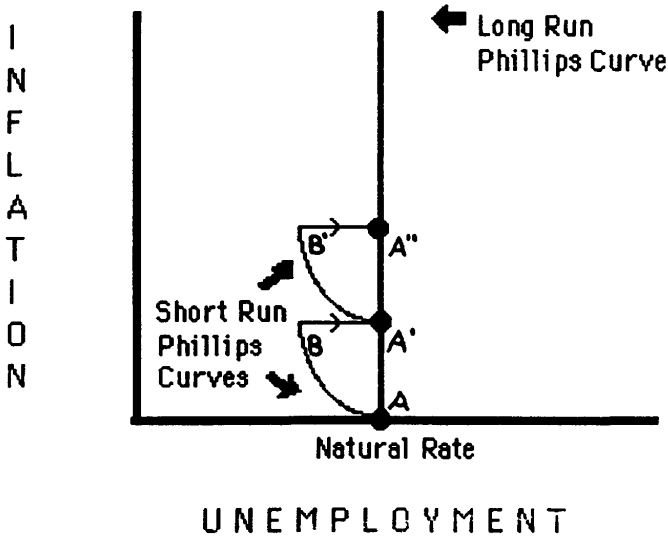


Figure 3

In the long run, however, different forces are at work. In the long run workers will realize that their real wages (wages adjusted for changes in the price level) are unanticipatedly less than their nominal wages because of the induced inflation. Workers will then demand higher wages to restore their real wages to the earlier level. This return of real wages to the earlier (higher) level erodes business profits and returns the level of unemployment to its earlier level. This is represented by a movement from point B to A' in the graph above. Looking back, policymakers will see that the reduction in unemployment is temporary and stems from the "unanticipated inflation" (the inflation that was in excess of what was expected) which the expansionary policy brought about. In Friedman's judgment, these long-run consequences will occur two to five years after the initial effects.

Of course, this cycle could be pursued indefinitely if we wish to accept ever-accelerating inflation. The monetary authorities could again use expansionary policy to move us now from point A' to B'. The improvement would only be temporary, however, and we would find ourselves at A'' in the long run. Expansionary policy cannot permanently reduce unemployment below the natural rate. In this model it is a mistake to embark on expansionary policies which seek to improve on point A. A long-run Phillips curve is represented by the vertical line.

Friedman criticized Phillips for a failure to make a clear distinction between real and nominal wages. The failure is due to the fact that Phillips wrote in a time and place in which stable prices were generally anticipated and there was therefore no divergence between real and nominal wages. Friedman's conclusions:

To state this conclusion differently, there is always a temporary trade-off between inflation and unemployment; there is no permanent trade-off. The temporary trade-off comes not from inflation per se, but from unanticipated inflation, which generally means, from a rising rate of inflation. The widespread belief that there is a permanent trade-off is a sophisticated version of the confusion between "high" and "rising" that we all recognize in simpler forms. A rising rate of inflation may reduce unemployment, a high rate will not.<sup>30</sup>

The idea that through the use of expansionary policies the level of unemployment cannot be permanently held below some natural rate without acceptance of ever-accelerating inflation is very important, and the battle to reduce the level of unemployment below this natural rate has shifted to other means, including the job-training programs of the 1960s, the Comprehensive Employment and Training Act (C.E.T.A.), and most recently the Job Training and Partnership Act (J.T.P.A.).

Friedman attributed the high inflation of the 1970s to the attempt by policymakers to exploit the relationship between inflation and unemployment as depicted in the Phillips curve through expansionary monetary policy. Not all economists would agree with him on this point. Many economists (especially Keynesians) will point out that there were "supply shocks"—decreases in aggregate supply—which at least partially account for higher prices, and the Keynesian school of macroeconomic theory presently represents the dominant school within the economics profession.

However, the idea so clearly pointed out by Friedman that expansionary policy cannot peg the rate of unemployment below some level has not been rejected. In his 1976 Nobel Prize address Friedman notes the following:

<sup>30</sup> Ibid. 11.

The "natural rate" or "accelerationist" or "expectations-adjusted Phillips curve" hypothesis—as it has been variously designated—is by now widely accepted by economists, though by no means universally. A few still cling to the original Phillips curve; more recognize the difference between short-run and long-run curves but regard even the long-run curve as negatively sloped, though more steeply so than the short-run curves. . . .<sup>31</sup>

This is important for our purposes because it is precisely such an attempt that the bishops' pastoral actually recommends as its primary strategy to reduce the unemployment rate to ethically acceptable levels. Indeed, the inability of the traditional tools of monetary and fiscal policy to reduce the unemployment rate to acceptable levels is precisely what has encouraged the growth of many new federal programs in the last 25 years to alleviate unemployment.

### *Neo-Keynesian Perspective*

Friedman's natural-rate hypothesis is "the contemporary version of the classical positions Keynes was opposing," while the Phillips curve is "in an important sense the postwar analogue of Keynesian wage and employment theory."<sup>32</sup> Keynes insisted that the economy could stabilize at a position entailing significant unemployment, and that expansionary policy could and should be used to alleviate the problem. Phillips may be said to have contributed the observation that inflation will be experienced before expansionary policy brings us to the full-employment threshold. Many economists continue to insist that low levels of inflation will accompany full employment in a changing economy.

The (dominant) Keynesian school today continues to accept the need for active aggregate-demand management policies to combat unemployment. They continue to accept the notion of a short-run Phillips curve, and some accept, as Friedman noted, even a long-run one (though it is thought to be steeper than the short-run Phillips curve). Unlike Friedman, they continue to accept the notion of a stable and exploitable inflation-unemployment trade-off within limits. Past some full-employment level of unemployment, the acceleration hypothesis has validity. The cause of the trade-off is still a matter of debate, but the idea of stochastic "supply shocks" figures highly in most explanations. Robert Heilbroner and James Galbraith have said that "inflation appears as the way in which the capitalist system responds to shocks and disruptions in the institutional setting of the late twentieth century."<sup>33</sup> For example,

<sup>31</sup> Arthur M. Okun and Martin Neil Bailly, eds., *The Battle against Unemployment and Inflation* (3rd ed. New York: Norton, 1982) 49.

<sup>32</sup> Tobin, "Inflation" 4.

<sup>33</sup> Robert L. Heilbroner and James Galbraith, *Macroeconomics* (8th ed. Englewood Cliffs, N.J.: Prentice Hall, 1987) 400.



events such as the oil-price increases of the early 1970s and the crop failures of that time constitute reductions in the level of aggregate supply and can result in simultaneous inflation and unemployment (stagflation). Furthermore, the economy may experience sectoral disequilibrium even in a state of macroequilibrium. For our purposes here we need not go into depth on this. It is sufficient to note that inflation may accompany full employment (the elimination of cyclical but not structural or frictional unemployment).

Which of the two theories (Keynesian or monetarist) is correct? I would not attempt to decide that here, and it is not necessary for our purposes. Is there any common ground between these two camps that would help us? It is clear that expansionary policy can *at best* work to bring about full employment, which is to reduce cyclical unemployment to zero—although there is disagreement over whether this will involve low levels of inflation. Both sides agree that it is possible to make further reductions in unemployment by continued expansionary policy, but they also agree that this can *not* be sustained in the long run.<sup>34</sup> Agreement exists on both sides that *structural* changes are necessary in the U.S. economy to achieve permanent reductions.<sup>35</sup> Although estimates range from 5 to 7 percent, economists today often use a number around 6 percent as a working number for the full-employment unemployment rate.<sup>36</sup> This is very far in excess of what is ethically acceptable from the standpoint of magisterial teaching, which has harked back to a time when the rates experienced were in the order of 1.2–3 percent. The suggestion today that monetary and fiscal policy should be used to peg unemployment to such low rates is bad economics indeed. Such a reduction is beyond the limits of monetary and fiscal policy.

### *Rational Expectations School*

The Phillips-curve issue has entered into one more stage of interpretation, and this is the most recent stage. The rational-expectations understanding represents a very hard reformulation of the classical model. It is an emerging perspective that has not won large numbers of followers. John Muth (the originator of the concept), Robert Lucas, and Thomas Sargent are leading economists in this school. As discussed

<sup>34</sup> Richard T. Froyen, *Macroeconomics* (New York: Macmillan, 1983) 286.

<sup>35</sup> Thomas M. Humphrey, *A History of the Phillips Curve* (Richmond, Va.: Federal Reserve Bank of Richmond, 1986) 31.

<sup>36</sup> The following authors have noted this consensus figure: Thomas Holloway, "The Cyclically Adjusted Federal Budget and Federal Debt: Revised and Updated Estimates," *Survey of Current Business*, March 1986; Donald Baumer and Carl E. Van Horn, *The Politics of Unemployment* (Washington, D.C.: Congressional Quarterly, 1985) 23; Robert Jerrett, *Public Works, Government Spending, and Job Creation* (New York: Praeger, 1979).

above, monetarism rejects the necessity and desirability of activist policies to stabilize output and employment at full-employment levels, while accepting the idea that monetary policy could indeed have real short-run effects. The rational-expectations school rejects the idea that systematic aggregate-demand management policies of any sort (fiscal or monetary) can have an impact in even the short-run real economy.

These economists reject the ideas that "markets don't clear," that people behave nonrationally, and that "justice" and other considerations have a role in explaining the behavior of economic agents. It is assumed that persons always behave in a maximizing way and that their behavior is not "adaptive" but "rational." This means for them that consumers form their expectations based on *present* data; they are not slowly adapting to new information. There is no period of time, no short run, in which workers do not realize that their real wages are less than nominal wages because of inflation caused by aggregate-demand management. This being the case, there cannot even be a short-run reduction in unemployment with higher inflation. Workers have the necessary information needed to remain in a utility-maximizing equilibrium.

The one possibility for disequilibrium concerns the possibility of stochastic "forecasting errors." The depressions and recessions (which were persistent deviations from full employment!) of the past are so explained. Many Keynesians consider this to be very unlikely (e.g., Tobin and Solow<sup>37</sup>).

The policy implications are much like those of the monetarists. Laissez faire in the economy is the indicated policy, since there is not even the possibility—let alone the need or desirability—of aggregate-demand management effecting a trade-off between inflation and unemployment in even the short run.

#### INFORMED ETHICAL REASONING ABOUT UNEMPLOYMENT

We have explored the world of economics in the depth that is adequate to inform ethical reasoning on the question of unemployment. We come now to the most interesting task: teasing out the implications of the above review for social ethics. The ethical dilemma presented by the unemployment problem involves one in certain options. The definition of these options varies somewhat depending on the diagnoses of the economic situation one accepts.

If we accept the need for full employment and embrace this as a desired end, and if we accept an early Keynesian understanding of the relation-

<sup>37</sup> See Arjo Klamer, *Conversations with Economists: New Classical Economists and Opponents Speak Out on the Current Controversy in Macroeconomics* (New Jersey: Rowman & Allanheld, 1983).

ship between full employment and inflation, there is little problem in terms of conflicting values. Because inflation is not encountered until the economy reaches full employment, we can accept the employment benefits of expansionary policy without any cost in terms of an inflation trade-off. However, the pastoral letter acknowledges the trade-off with inflation and the bishops have clearly moved beyond this understanding.

If we accept the need for full employment and embrace this as a desired end, and if we accept an understanding of the relationship between full employment and inflation that is informed by the work of Phillips (and by the work of U.S. economists who follow his line of thought), a serious conflict of values is involved. Inflation is encountered before full employment is reached, and we must make hard choices about how much unemployment and how much inflation is to be tolerated. Less of one evil entails more of the other. Now if we also assume that inflation hurts the poor less than does unemployment, and if we make a commitment to give the poor priority in the formation of social policy, then we will not be inclined to battle inflation at the cost of higher unemployment. We would insist on sliding happily along the Phillips curve to at most a 3 percent unemployment rate. This definition of the problem would appear to be the one embraced today by U.S. Catholic social teaching.

If the monetarist diagnosis of the relationship between unemployment and inflation is correct, the range of choices to fight unemployment is quite narrow. Expansionary monetary and fiscal policy can only yield short-run benefits, while resulting in an ever-accelerating inflation which can only be ruinous. Why should we take steps to reduce unemployment at the cost of inflation when these steps cannot even (permanently) reduce unemployment? To abandon the expansionary course will result in a short-run increase in unemployment while inflation and inflation expectations fall. This is what has been called in the media the "cruel monetarism" of some conservative leaders. However, these remedies follow directly from the diagnosis. Ethicists at this point would be in search of some policy recommendation that meets the demands of ethical theory and is efficient in achieving the desired ends. Expansionary monetary and fiscal policy is not efficient in achieving the desired ends. Ethicists might demand public assistance, or even public employment, for those without jobs. Calls for structural changes in the labor market must follow.

The rational-expectations school leaves us in the same position from an ethical perspective. Laissez faire in the economy is the indicated policy, since there is not even the possibility of aggregate-demand management effecting a trade-off between inflation and unemployment in even the short run. Only structural changes might help us here.

If we accept the modern estimation of full employment in the area of 6 percent, and take the Keynesian position that supply shocks and changes in the labor market are to be blamed for much of the rise in unemployment, then we may call for expansionary policy to reduce unemployment and smooth out the business cycle only up to the point of full employment—6 percent. Once again, we may with consistency advocate job-training and public-employment programs, as well as other structural changes that would improve the labor market.

Because the pastoral speaks about a workable and feasible trade-off between inflation and unemployment that may be exploited through monetary and fiscal policy, it is clear that the letter contains an implicit preference for Keynesian economics. However, it is not a proposition of Keynesianism today (and most certainly not of monetarism) that unemployment can be reduced through monetary and fiscal policies to the levels which the bishops seem to desire. If 6 percent unemployment is taken as the full-employment unemployment rate which is attainable through expansionary policy, then what is ethically acceptable from the standpoint of magisterial teaching will require other means. In this respect the pastoral reads as if it had been written in the very early 1960s. It has moved beyond the point of considering full employment the inflation threshold (as Keynes did). There is the acknowledgment that inflation may accompany full employment in the U.S. which Samuelson and Solow (1960) had shown. However, there is little understanding about the recent changes in the labor market and what are believed to be the limits of expansionary policy.

#### DEALING WITH THE PLURALISM IN ECONOMIC SCIENCE

We have seen that the primary strategy recommended by the U.S. bishops to attain their particular concept of full employment is dated and not credible from the perspective of any one of the modern schools of economics. Although the bishops never define their concept of full employment with precision, they lament that the unemployment rate has drifted upwards since World War II, when it reached lows between 1.2 and 3 percent of the labor force. Expansionary monetary and fiscal policy cannot be the main instrument to achieve such levels of unemployment. Furthermore, there is at the present time no consensus on which theory of macroeconomics best describes the workings of our economy. Depending on which school of economic thought one accepts, the options with which one is presented in an ethical analysis are seen to be very different indeed. This pluralism cannot be eliminated. A healthy debate may be characterized by unity on ethical principles, but an attempted unity on implementation will end discussion. The bishops

need the economics experts who can more carefully find the means to the desired ends. However, it would be helpful to understand as much as possible about the probable reasons why the bishops assumed a Keynesian policy stance as their response to pluralism in economic science.

The grounds on which this stance has been made are not made explicit in the letter. Furthermore, a host of issues related to the teaching authority of the document will tend to arise. Clearly, the pluralism in macroeconomics has not been dealt with in a very sophisticated way. How do the bishops explain the choice of means used to achieve their desired ends? About what might be called their macroeconomic “short-hand,” they say:

We situate our discussion within a context of diverse and competing views of how to understand the American economic system. One such analysis assumes that an unfettered free market economy—where owners, workers, and consumers are allowed to pursue their individual self-interest—provides the greatest possible liberty, material welfare, and equity. . . . A second view argues that current economic problems are inherent in the very nature of the capitalist system. In this view capitalism cannot be reformed, but must be replaced. . . . Catholic social teaching has traditionally rejected both of these ideological extremes, for they are likely to produce results contrary to human dignity and economic justice. . . . Therefore, our approach in analyzing the U.S. economy is pragmatic and evolutionary in nature.<sup>38</sup>

Of course, pragmatic recommendations that are intellectually responsible are made in the context of some particular economic theory. As I have said, the working theory seems to be distinctly Keynesian.

James Gustafson has written a helpful essay on the problem of pluralism in the social sciences.<sup>39</sup> According to Gustafson, there are three methods by which the ethicist/moralist may choose among different interpretations of a field.<sup>40</sup> The moralist may accept an interpretation on its “scientific” adequacy. In this case the moralist must make the case for such choice on scientific grounds. Second, the moralist may choose an interpretation that has an affinity with his or her own philosophical or theological point of view. In this case he or she must explain why his or her own philosophical or theological point of view is more adequate and why study done from this perspective is also more likely to be empirically adequate. Third, the moralist may use empirical research for

<sup>38</sup> *Economic Justice for All* (1986), par. 37.

<sup>39</sup> James Gustafson, *Theology and Christian Ethics* (Philadelphia: United Church, 1974) chap. 11.

<sup>40</sup> *Ibid.* 227–28.

sources of insight into the nature of the person in society. In this case she or he does not rely on any authority other than her or his own in the interpretation of data.

My sense is that the second possibility figures at least somewhat in the choice. According to the second possibility, an interpretation has been chosen that has an affinity with the Catholic theological point of view. I feel that these affinities may exist in the following three areas: (1) a more pessimistic view of a market system; (2) the role of the state; (3) an openness to social engineering.

It will be recalled that, unlike the classical economists, Keynes felt that because of the variability of aggregate demand and the lack of flexibility in labor markets, the market system did not have a mechanism to guarantee full employment. Keynes therefore introduced a new and more active role for the state in aggregate-demand management. Government spending and taxation should be managed by the fiscal policymakers. Furthermore, a host of other social goals might be accomplished at the same time. Poverty, for example, might be reduced through a progressive income tax.

Catholic social teaching has generally viewed markets with suspicion. It has also encouraged governments to take a more active role in the pursuit of the common good than the classical economists did. Finally, it has insisted that social ills be addressed especially in the option for the poor. At the same time, the classical economists, and those who have reformulated classical theory more recently, seem less sensitive to the plight of the poor. So we see that Keynesian economics has some affinity with the Catholic theological point of view.

Although there may be such an affinity, the bishops have yet to admit explicitly their preference for a specific school of macroeconomics, and they have not yet explained why study done from their perspective is also more likely to be empirically adequate.

Besides choice of an interpretation of a field and justification thereof, there is yet another possibility for dealing with the pluralism in macroeconomics, one which I advocate. The ethicist need not adopt a particular interpretation of a field. Instead, position papers from various perspectives (schools) are encouraged and are scrutinized for their consistency with ethical principles. Keynesians, monetarists, and others will submit proposals. Their recommendations will certainly vary concerning the role of monetary and fiscal policy and the role and types of structural reform. There would be three distinct moments in this process. We begin with the bishops and the pastoral letter; then we expect position papers from economists; finally, we need interdisciplinary thinkers who understand theology and economics sufficiently to judge the papers for their consist-

ency with ethical principles.<sup>41</sup> Along these general lines William Byron has said that these attempts would be

authoritative not because the bishops published them, but because the authors would be authorities in their fields. The appropriate role of the bishops as commissioners and publishers would be to review the work of the experts for consistency with the moral principles the bishops have articulated in their letter. If the policy proposal fits the principles, let the proposal be published so that it can be tried by government, or business, or the unions, or any appropriate economic actor.<sup>42</sup>

As mentioned earlier, Byron offers a helpful list of five categories to which the experts should address themselves: employment and unemployment, poverty, food and agriculture, the U.S. and the world economy, and the new American experiment.

My own thinking is only slightly different from Byron's. I believe there should be extended and thorough discussion about such position papers, but that complex recommendations generally ought not be published by the bishops. It makes less sense to me to have the bishops act as publishers of complex proposals in light of the economic pluralism discussed here, and because it seems to misstate and perhaps overstate the bishops' role in the process. Ultimately, the choice of policies to be tried occurs in a political forum under more democratic conditions, and the bishops cannot somehow represent the consummation of a process that involves all persons of good will. There should be more forums and journals dedicated to "economic justice" which would advance the state of our knowledge in economic justice. The pastoral should serve as an impetus for public discussion and creative scholarship primarily by offering ethical principles and denouncing injustice.

This method would allow the bishops to remain within their sphere of competence and allow economists to have theirs. It would have steered the bishops clear of their technical/economic error concerning the limits of monetary and fiscal policy. Most importantly, it would not have stifled debate by subliminally declaring a Christian economics. This approach would not only allow but more actively encourage position papers to give the principles their incarnation in economic life.

<sup>41</sup> Because there are many writers of ethical theory and no shortage of economists, it is this new category of interdisciplinary thinkers who are likely to be in shortest supply.

<sup>42</sup> See Byron, "The Bishops' Letter" 253.