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WEEK OF MAY 1, 2006—OUR AFFLUENT SOCIETY

John Kenneth Galbraith, author of “The Affluent Society” and a great economist, lived 97 years. His recent passing has signaled the passing of a great age in economics, also. For he exemplified the best of America, by advocating that we look beyond the production of material goods to enhancement of the public good. He believed that it was more important to spend for good schools and healthcare than the latest high tech armaments, that the condition of our infrastructure was at least as important as maximizing the profits of corporations.

Economics has always been a social science that studied the financial behavior of our species, high and low. Galbraith was able to study human nature at the center of American power from the Great Depression through World War II as an official in the Roosevelt Administration. And no one understood better the relationship between power and the powerless.

As he predicted in “The Affluent Society”, we find ourselves today in an overly-affluent society, yet have spent the least on our greatest necessities: education, healthcare and affordable housing. Since affordable housing is no longer available in the most desirable places to live and work and we have spent little on modernizing our transportation infrastructure, the environment suffers from workers living too great a distance from their workplace. And the 24-hour consumption of cheap goods in places such as Wal-Mart has trumped a living wage for the majority of our population—even the middle class.

Today we are faced with a scarcity in housing (as well as good educational opportunities for coming generations) that was barely comprehensible just a generation ago. In the early 1970s on the South Coast, for example, a $12,000 per year income was enough to buy the average house costing $20-40,000 then. That home now costs around $1 million, and requires an $180,000 annual income. This is when today’s average annual household income is $64,000.

Goods are still cheap and plentiful, even if housing is not. But that could change, as a greater scarcity creeps into energy prices, then other resources. This will only continue to deflate the value of our dollar, which will ultimately make all goods more expensive.

The economic picture is exceeding expectations, including those of Federal Reserve officials. The manufacturing and service sectors of our economy are expanding again, personal income and expenditures are highest since last Sept., and first quarter GDP growth jumped, which means the economy is nearing full capacity. All of this is bumping up the inflation rate. When, then, is a good time for the Federal Reserve to stop raising interest rates?

MANUFACTURING & SERVICE SECTOR CTIVITY—Both indexes of the Institute for Supply Management (ISM) increased for March. Prices and employment also rose in both sectors. New factory orders jumped 4.2 percent in the latest data, which indicates that the manufacturing sector is just picking up steam. The fastest growing services are entertainment and real estate, by the way.

PERSONAL INCOMES—A puzzle for the Federal Reserve is that spending has not slowed appreciably with rising energy costs and interest rates. Personal incomes rose 0.8 percent and spending 0.6 percent in March, leaving the personal savings rate still negative, where it has been since last March. And the PCE inflation index rose 0.4 percent, the largest gain since Oct. This tells the Fed that either interest rates are not high enough yet to encourage less spending and more savings, or the last 15 rate hikes are slow to take effect.

GROSS DOMESTIC PRODUCT—First quarter growth increased 4.8 percent, slightly below the consensus. This helped bond prices, paradoxically, since its core consumer price index rose just 2 percent. The first quarter Employment Cost Index, another inflation indicator, also showed a slower increase, particularly in benefit costs.

Professor Galbraith's answer to foreign competition and falling wages was a society that concentrated less on private consumption—which has now climbed to 71 percent of GDP—and more on public investment in our future well-being. The government would step in during lean times as Keynesian economics decreed, but raise taxes during prosperous times to minimize our indebtedness.

He was tied to no one economic theory, though he leaned to Keynesian-style central planning to get us through depressions and wars. Our economy had to be managed to some extent to make sure it benefited all Americans during those times, not just the well-educated and wealthy.

A recent Wall Street Journal "evaluation" of Galbraith mentioned why "our houses are generally clean and our streets generally filthy." It is the "tragedy of the commons", said the WSJ writer, "since no one owns the streets, no one has an incentive to take care of them."

Galbraith's response was that it is precisely a "tragedy of the commons" when public welfare gets trumped by private ownership—whether it is with infrastructure, the environment, education, or health care. Classical economics decrees that private ownership is the 'highest moral order' (in Alan Greenspan's words). So it is when public ownership is neglected that we have dirty streets (and dirty air).