

Falling Prices and Terrorism: The Tragic Obverse of the Cost Disease

William J. Baumol

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The following is the speech William J. Baumol gave at the dinner EPS gave in his honor at the 2007 ASSA Conference in Chicago. -ed.

"Pecunia Nervus Belli" (Money is the sinew of war).

Cited in Howard, 1976, p. 27, who describes it as "...the favorite Latin tag of the [mid-16th century]."

"There were, Louis XII was told by one of his counselors, three things a king required in order to fight wars: First, money; second, money; and third, money."
Jones, 1994, p. 130.

"Nowadays the whole art of war is reduced to money: and nowadays, that prince who can best find money to feed, clothe and pay his army, not he that has the most valiant troops, is surest of success and conquest."

Charles Davenant, 17th century, as cited in Howard, 1976, p. 48.

[the AK-47] "...has become the world's most prolific and effective combat weapon, a device so cheap and simple that it can be bought in many countries for less than the cost of a live chicken" (Kahaner, 2006).

The much discussed phenomenon that Alice Vandermuelen kindly dubbed Baumol's Disease - which entails perpetually rising real prices of health care, education and the arts - is generally interpreted to foretell a grim future. But the late Senator Daniel Patrick Moynihan was precisely right when he characterized these prospects, rather, as a fundamentally optimistic forecast. Here, I will explain this evidently paradoxical conclusion as a prelude to two very pertinent assertions: First, that the correct obverse of Baumol's disease is the observation that there must also be an accompanying set of outputs whose real prices are destined to fall with little let-up and, second, that it is in these falling prices, rather than in those that are remorselessly rising, that the true tragedy of Baumol's disease is to be found. These assertions would seem to be paradox enough. But what, if anything, is their connection to the concerns of Economists for Peace and Security? My contention is that it lies at the heart of those concerns-the threat of terrorism and its frightening prospects for the survival of civilization and even of mankind.

The Cost Disease and its Dangerously Declining Prices

To show the connection, I must be excused for offering yet another (mercifully brief) explanation of the cost disease. The source of that disease is made clear by analogy with a newspaper headline that I saw when I first arrived in England in 1946. As I recall, it sought to shock readers by lamenting, "Nearly Half of UK Student Grades are Below Average." The cost disease is just like that. Since any index of the overall price level is just an average of the prices in the economy, it follows that if the prices of all commodities are not rising at the same

pace, then some will be above average (i.e., their relative costs and "real prices" must be rising), while others must be characterized by real prices that are falling. That rudimentary tautology is almost all there is to the cost disease. Its only additional element is the observation that the set of those items whose real prices are rising is roughly unchanging, decade after decade, and the same appears to be true of those that are falling. The explanation is not difficult. The items in the rising-cost (price) group generally have a handicraft element in their production process, whose labor content is therefore difficult to cut down. Those in the other group are predominantly manufactures that are more easily automated and whose consequently falling labor content is just the other side of their steadily rising labor productivity.

This explains Senator Moynihan's sanguine interpretation of the cost disease. For its explanation is to be found in the uneven pace of the economy's near universal productivity growth. But where productivity in almost every area of the economy is growing, the rising prices - even if they are "real prices" - do not imply that we face a mandatory retrenchment in our consumption of the affected products. On the contrary, universal productivity growth means that society can afford to consume ever more of every one of its products, which should hardly be a depressing prospect. That explains Moynihan's paradox, but it also brings us to the point of my story: the remarkable decline in the cost of manufactures, *among which are to be found the weapons that are the instruments of terror.*

Evolution of Military Technology and the Threat to Society

Military equipment, or at least some of it, is no different. While the cost of the latest fighter jet goes heavenward and the military budgets of the world's major powers impose damaging deficits upon their governments, bargain-basement equipment has also made its appearance (note the quotation from the *Washington Post* at the head of this article). The terrorists and guerillas of the world have demonstrated beyond doubt how effectively these kinds of products can be put to use, and have proven how effective such weaponry can be in stymieing the most determined counter-efforts of major powers equipped with extensive manpower, organized forces, and every device that money can buy. Perhaps for the first time in history, vastly superior wealth, utilized with thought and determination (as, for example, occurred in the case of General Ulysses S. Grant's destruction of the Confederate army of the evidently cleverer General Robert E. Lee), no longer assures military success. *Wealth is no longer the near guarantor of military success*, as it apparently used to be, if the quotations of the beginning of this paper are right.

The technology of warfare clearly has continued to evolve, arguably outpacing the incredible and utterly unprecedented pace of innovation in general during the past two centuries. There have been two major consequences critical for my topic. First, of course, is the plain fact that humanity now has it in its power to commit suicide, finally and completely, via nuclear holocaust. And, as just noted, developments in military technology have produced an outpouring of powerful and often bargain-basement-priced products, with a number of doomsday weapons among them-be they biological, chemical, or nuclear.

One of the most chilling prospects, in the wake of the events of September 11, 2001, is the possibility that the perpetrators could strike again, this time with nuclear weapons, including so-called dirty bombs (in which the waste products of nuclear reactors are wrapped in conventional explosives), or a terrorist attack on a commercial nuclear power plant utilizing a commercial jet or heavy munitions, or the possibility that terrorists could build or obtain an actual atomic bomb and detonate it in a city. While it is less likely that "fly-by-night" terrorist groups could produce sophisticated nuclear devices, a greater threat is a nationally-supported program under the sponsorship of a malevolent rogue regime that provides the necessary resources and facilities. With more nations "going nuclear" or wanting to go nuclear, the possibilities are all too frightening. [A recent *New York Times* article reported that North Korea's successful atomic test this year "...brought to nine the number of nations

believed to have nuclear arms. But atomic officials estimate that as many as 40 more countries have the technical skill, and in some cases the required material, to build a bomb" (Broad and Sanger, 2006).]

What Can be Done?

It is not my purpose here to shock, discourage, or preach to the already converted. Rather, my comments are meant as prologue to a consideration of what can serve as an effective countermeasure to the nuclear, biological and other terrorist threats. And certainly I do trust that we will never surrender to the threat we face.

Regretfully, I must start off by recognizing what we all know: that there is no guaranteed preventative. There is, however, an observation that offers some degree of hope. Although within the population of the US, as in other industrialized nations, there are deranged individuals who place no value on human life and who adopt homicide as a hobby, the organized police establishments have, at least so far, been able to keep the activities of such sociopaths under control. The horrors the killers commit have been narrowly circumscribed and the general population protected. This is something that can be accomplished only by a well-organized and unified government. It cannot be done by international conferences that are able to agree only on toothless compromises, or regularly break down altogether, like the talks intended to eliminate barriers to trade. Thus, I am arguing that the threat of nuclear terror can only be countered effectively by an international police force with the authority to adopt all necessary actions, including the requisite intelligence activity, and not subject to single government veto, although carefully circumscribed in the rules of its constitution. Such a police force must be permitted to take action only against a limited and carefully specified set of phenomena-possession of nuclear weapons, acts of genocide, and the like. An international police force must be given the power to intervene and the duty to intervene quickly and effectively against rogue individuals and rogue states whose actions threaten human survival or the survival of segments of humanity distinguished by religion, race or nationality.

Some Ruminations on Feasibility and Strategy

This suggestion is clearly not new and certainly seems utopian. Yet I will argue next that it is not as impractical as it may appear to be. Moreover, it would seem that there is no alternative. First, let it be made clear that what I propose is not in any sense an international government but, rather, only an international police force with very limited tasks and available courses of action. Such a force would not limit the monetary or fiscal policy of any government, or any governmental rules on punishment of larceny, divorce or enforcement of contracts, for example. My proposal, in other words, is very limited in the objectives it undertakes to pursue and the means it proposes to pursue them.

Second, unlike the threat of global warming, which can be denigrated and minimized by those who profit from the status quo, surely no one can any longer mislead the general public into believing that the threat of nuclear terror is a fairy tale. And once the magnitude and imminence of the threat is recognized, surely the public can be stirred to action. As Samuel Johnson put it, "Depend upon it, sir, when a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully" (Boswell, 1811). If we can succeed in keeping the imminence and horror of the threat before the community, the prospects are that political leaders will be forced to focus on this issue.

One promising tactic might be to create a contingency plan that can quickly be executed at a time of evident emergency. The timing must be selected carefully, waiting for a crisis when the urgent demand for action is nearly universal. The essence of the matter is to have worked things out carefully beforehand, as used to be done so successfully by Robert Moses, New York's parks and road builder extraordinaire who almost always managed to have his way in the competitive struggle for public resources by having his pre-worked-out program at the

ready, while his rivals had as yet only begun to think of their positions.

Finally, history gives us encouragement in the example of the adoption of the Constitution of the United States. Until the Constitution was ratified-years after the independence of the former colonies had been achieved through military victory-the states were connected extremely loosely in a confederation that left them all but independent. There were powerful forces in each state of the future US determinedly opposed to giving up any iota of its power for independent action. And yet, circumstances forced adoption. One can well imagine how different subsequent history would have been, probably with frequent quarrels and even warfare between states, if these forces of resistance had been successful. Such prospects made possible the narrow victory for those who sought a stronger and more effective union. How much more effective the incentive introduced by the prospect of the destruction of humanity may yet prove to be.

Perhaps the strongest source of support may prove to be realization that there appears to be no other solution. Without an effective and powerful international police force created and supported by most of humanity and the nations into which humanity is divided, we seem condemned to leave ourselves defenseless to the madmen who are ready to destroy us all.

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