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THE USES OF ECONOMIC KNOWLEDGE

Remarks by Gardner Ackley
Chairman, Council of Economic Advisers
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Let me begin by expressing the joy that any Michigan man feels when he returns to Ann Arbor. It is a sentiment that all of us -- with the appropriate cynicism of new graduates -- once found incomprehensible and faintly amusing on the part of our elders. Yet I predict that one day you new graduates, too, will share the sentimental joys of homecoming -- and I hope that you will find many occasions to indulge them.

I return, of course, not only as an alumnus, but as a permanent member of the University family, struggling in the distant wastelands of Washington. It is not necessarily a lonely place for a Michigan man. All too often I run into Undersecretary Wilbur Cohen of HEW -- trying to spend the people's money on his wild social projects. Once in a while I see Assistant Secretary of Interior Stanley Cain -- when he's in Washington to pick up clean shirts between his travels.

Other Michigan faculty and alumni are everywhere in Washington -- some full-time, others only passing through. One of my colleagues on the Council of Economic Advisers, Professor-on-leave James Duesenberry

of Harvard, has 3 degrees in economics from Michigan -- and claims that he was once a student in one of my classes. Other Michigan alumni are everywhere in the Executive Branch, the Congress, or representing the interest groups that crowd our capital.

And the number of Michigan deans and faculty in Washington to pick up research, construction, or other handouts from the Federal treasury, or to advise and consult with some Federal agency or Congressional Committee, would permit a rump Michigan faculty meeting in Washington almost any day of the week.

Even so, seeing Michigan men and women in Washington does not provide the same pleasures I find in returning to Ann Arbor.

Yet on each of my occasional visits here, one disquieting question stares me in the face. If President Hatcher, or Dean Haber, or Chairman Smith of my Department is too polite to ask it, I ask it myself. Why don't I stay here, where I belong? What am I doing in Washington that's so important? What better can the teacher and scholar contribute to the life of the Nation than teaching and scholarship -- pursued, as they can only effectively be pursued, on a University campus?

There are rough days and stern seasons when I am all too tempted to answer these questions by packing my bag for Ann Arbor. Yet up to now I haven't done so. What I want to talk about today is at least related to the reasons I am still in Washington.

The uses of knowledge in society is a perennial concern of social philosophers. But it is far too broad a subject for a commencement address, and far too complex for a mere economist. (I exclude Kenneth Boulding, as no mere economist.) But I want to make a few observations on one limited piece of this subject -- the uses of economic knowledge, and particularly its uses in national economic policy.

Thirty years ago, John Maynard Keynes -- later Lord Keynes -- concluded the greatest work in economics of the past century with some eloquent words which, as a young professor, I would sometimes read to a class on the last day of the semester:

> "...the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back. I am sure that the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval; for in the field of economic and political philosophy there are not many who are influenced by new theories after they are twenty-five

or thirty years of age, so that the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest. But, soon or late, it is ideas, not vested interests, which are dangerous for good or evil."

I guess that I enjoyed those words more when I was myself 25 or 30 years of age, convinced that my economic ideas were the newest -- and, of course, that they could be dangerous only for good. But if Keynes was even 10% correct about the importance of economic ideas in society, then surely the academic scribbler had better be careful what he writes. And the practical maker of policy had better take care to which economist -- alive or defunct -- he enslaves himself.

I would hazard that the best Commencement Address of the 1962 season was made at Yale University by the late President Kennedy. What he said bore some relation to Keynes' proposition. It was a speech about inherited myths and cliches in the field of economic policy, that permit us to "enjoy the comfort of opinion without the discomfort of thought;" about the stereotypes that keep our political debates and public discourse "clogged by illusion and platitude," unable "to reflect the true realities of contemporary American society."

"What is at stake in our economic decisions today," he said, "is not some grand warfare of rival ideologies which will sweep the country with passion but the practical management of a modern economy.

What we need is not labels and cliches but more basic discussion of the sophisticated and technical questions involved in keeping a great economic machine moving ahead."

The President's speech was not well-received in the business and financial communities. It came only a few months after the confrontation on steel prices. The stock market was still reeling from the combined effects of that showdown plus clear evidence that economic recovery was tapering off. Only 18 months from the end of the last recession, fears were emerging of a new one. Rumors were abroad that the President's academic economists -- avowed disciples of an English economist named Keynes -- were beginning to talk of a tax cut in the face of enlarging Federal deficits. The speech was read as evidence that the young President was preparing new and unconventional economic adventures.

Yet, looking back, the Yale speech probably marked a turning point in public and business attitudes toward economic policy. The "more basic discussion of the sophisticated and technical questions involved in keeping a great economic machine moving ahead" did begin to take place. Such purely academic ideas as "multiplier," "accelerator," "full employment surplus," "GNP gap" moved out of the classrooms and learned journals into Congressional hearings and debates, the daily newspapers, and the journals of opinion -- to be sure, still competing with an abundant dose of the older cliches. Given a crucial push by a

new President, a massive tax cut was enacted early in 1964, with the widespread support of business and financial leaders, and in the face of a budget deficit then forecast at $10 billion.

The action was truly a triumph for a defunct academic scribbler of a few years back -- our very same Lord Keynes. And when the tax cut produced the surge of prosperity that its advocates had predicted, the prestige of economists soared along with the GNP. The "new economics" became a household expression -- whether or not its content was understood. In business as in Government, economists are now in danger of becoming part of the Establishment.

Before we celebrate too readily this triumph of reasoned scholarship over myth and cliche, we should look back again at Keynes' words: that the ideas of economists and political philosophers are "dangerous for good or evil;" and that ". . . the ideas which civil servants and politicians and even agitators apply to current events are not likely to be the newest."

Certainly the Keynesian ideas that Walter Heller and Paul Samuelson were teaching President Kennedy in 1961 and 1962 were not new. Academically speaking, they were old stuff -- the commonplace of every elementary textbook for more than a decade. If there was anything new about the "new economics," it was the invention of some new pedagogical devices -- concepts, slogans, quantifications -- which made the message comprehensible and meaningful to the men in authority, and got them to listen and to learn.

But could it happen that a simplified and popularized version of this not very new economics might itself become part of a new mythology of public policy, dangerous for evil as well as for good?

From 1961 through 1964 and well into 1965, most economists in and out of the Government were preaching -- and properly so -- the virtues of expansionary Federal policies: the stimulation of demand in order to bring into full use the vast and growing productive powers of the world's most powerful economic machine. That lesson of the new economics was well taught and well learned. And it would be hard to dispute that its application up to now has been almost wholly for the good. But that one lesson is far from the whole of the economics derived from Keynes, just as Keynesian economics is far from the whole of economic knowledge.

The economics of full employment prescribes that total market demand should be adequate to use fully the growing productive power of the Nation. But it equally prescribes that once that productive power is fully used, the expansion of demand must then no more than keep pace with the growth of our ability to produce.

It is fully in line with this precept that the fiscal and monetary policies of the Federal Government moved away from stimulus and toward moderate restraint beginning last winter.

Some critics of deliberately expansionary policies have argued all along that we would not know when to stop stimulating demand -- that we would overdo it, and bring on inflation. Excessive sensitivity to this criticism may have led some economists who had earlier been strenuous

advocates of expansionary economic policies to conclude too soon and too positively that a much stronger shift to restriction was appropriate. I do not propose to argue that issue today.

But it is already clear that it is just as difficult to sell an adequately restrictive policy as it was earlier to sell an adequately expansionary one. And some who learned too well the first lesson of the new economics tend now to invoke the authority of Keynes and Heller to support the myth that as long as one man or machine is unemployed we must not restrict the expansion of demand.

For example, many today are raising loud outcries -- some in the name of the "new economics" -- against the restrictive monetary policies of the Federal Reserve System. A few argue -- quite reasonably -- that our "mix" of restrictive policies is wrong -- that we should have a more restrictive fiscal policy and a less restrictive monetary policy. That preference is understandable; there are many economists who share it. Some are concerned that, unless safeguards are established to distribute the burden, the impact of tight money could be excessively and inequitably concentrated on the homebuilding industry. That concern is understandable. Some propose techniques designed to minimize the interest rate increases that are bound to accompany restricted supplies of credit. That, too, is an understandable position.

But the more common view of those attacking the current monetary policy is that we should merely loosen up on credit without tightening fiscal policy.

Equally disturbing, to me, is the apparent readiness of many in the Congress to add vast sums -- up to $5 or $6 billion -- to their favorite civilian expenditures programs without either cutting back other expenditures, or facing up to the probable need to offset the inflationary impact by higher taxes. Once again, a demonstration of economic lessons unlearned.

Another example of resistance to the application of economic knowledge appears in the area of wages and prices. It is a matter of simple economic arithmetic that if the average of hourly employee compensation rises more rapidly than the average gain of output per man hour -- now a little over 3% a year -- the labor cost of the average unit of output will rise. Since labor costs are close to two-thirds of the total cost of production, prices will inevitably rise, too.

Perhaps those labor unions which demand and are able to force on their employers wage increases of 5, 6, or even 9 percent a year think that most other unions will settle for 1 or 2 percent a year, so that the average of all labor costs will be stable. Or perhaps they believe that a general rise in labor costs can and will be absorbed by business, without provoking a general inflation of prices that will erode the value of their own excessive gains. I doubt it. A better explanation is merely that they have not learned a simple piece of economic arithmetic.

No greater economic sophistication is evident in the pricing policies of some of our large corporations. Once we are at full employment, a set of pricing policies on the part of business generally that attempts to raise the profits share of our national income can be consistent with price stability only if some other group -- and that mainly means labor -- is willing to let its share of the national income decline.

Perhaps some individual corporations believe that other businesses will gladly narrow their earnings so that their own higher prices and profits will not eat into labor's share of the pie -- provoking labor to raise further its wage demands. Again, I doubt it.

A national wage and price policy consistent with over-all price stability -- yet which permits the necessary readjustments of relative wages and relative rates of return on capital -- is no easy task to devise. The policy we have relied on -- our wage and price guideposts -- is surely far from ideal, and has recently suffered some stunning defeats. But what is more disappointing than the specific defeats is the absence of much apparent recognition on the side of either labor or management that this problem must be solved if we are to maintain full employment and the full measure of wage and profit incomes that only a full employment economy can provide.

When President Kennedy took office in early 1961 he was intrigued by the success of many nations of Western Europe in achieving high levels of employment and rapid economic growth while preserving reasonable stability of prices and costs. He tended to attribute this to a greater degree of economic sophistication abroad -- the most intelligent application of economic knowledge to their affairs -- their greater freedom from the economic mythology and cliches which seemed to handicap American policymakers. He referred to this several times in his Yale speech.

Unfortunately, the experience of more recent years does not vindicate the President's judgment. The current economic crisis in England -- the nursery of most of the world's great economists from Adam Smith through Keynes -- like the experience of other countries

of Western Europe, does not suggest that economic knowledge has anywhere been adequately applied to national economic policy.

Let me not mislead you. Our present knowledge of economics -- great as its advance has been in our lifetimes -- is only the beginning of what we need to know. The intensification of research -- mainly in the universities -- is an urgent need.

But we can do a far superior job of applying that which we do know.

I conclude with some words which Kenneth Boulding addressed to his fellow economists last December.

> "...We are still, like Isaac Newton, only a boy playing on the seashore, and the great ocean of Truth still lies all undiscovered before us. That undiscovered ocean is Man himself. What we discover about him, I hope, will be for his healing. I did not become an economist for anybody's applause; I became an economist because I though there was an intellectual task ahead, of desperate importance for the welfare and even the survival of mankind. A mere thirty-five years have not been long enough to change my motivation. Something has been accomplished; a great deal more remains to be done. To this unfinished task I commend us all."