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President's Report and Future Research Possibilities

RESEARCH PRIORITIES AMIDST CHANGING ECONOMIC AND SOCIAL VALUES

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An intensive review of the National Bureau's research program seems in order for many reasons this year. 1976 is, in fact, a rather important anniversary for economists, particularly United States economists—and for reasons going well beyond the fact that this is the U.S. Bicentennial. For example, 1976 is also the bicentennial of the first publication of Adam Smith's *Wealth of Nations*. More immediately, 1976 is also the 30th anniversary of the Full Employment Act, an act which marked a significant turning point in economic policy. That act was legislated soon after World War II amidst worries about the possibility of stagnation returning to the American economy. Most economists in 1945, anticipating an end to large federal outlays for defense, were predicting a renewal of the widespread unemployment and depression that characterized the prewar or Great Depression years.

Those worries, as we now know, never came to fruition. The major reason was that the "tools" of economic policy were greatly improved by developments that occurred just shortly before the outbreak of World War II. In particular, national income modeling, based on the theories of Keynes and others, became empirically implementable because of the development of better and more sophisticated national income accounts through the efforts of Simon Kuznets, George Jaszi, Solomon Fabricant and others working at the National Bureau, in the Department of Commerce, and elsewhere. It does not stretch the truth too much to claim that this fusion of national income and accounting models laid the basis for the development of effective cyclical stabilization policies for the major industrial economies of the world during those early postwar years. Indeed, from this fusion a remarkably broad consensus emerged about what should be the major macroeconomic policies within the United States, and apparently in Western Europe and Japan as well. It is a consensus, moreover, that was rather broadly accepted by both business and labor, and by most major political parties. It is not surprising, therefore, that this same consensus has had a major influence on conditioning the research choices made at the National Bureau and elsewhere within the profession.

This "Full Employment" consensus of the postwar years was based on three fundamental beliefs: (1) that unemployment was *the* major social and economic problem of domestic society; (2) that economic growth was desirable in and of itself and would generate an economic dividend that could correct, or at least hold in abeyance, most of the other major problems of society; and (3) that price inflation was not too worrisome, and possibly, something to be welcomed within reasonable bounds. (Inflation seemingly provided a partial correction for various economic miscalculations, such as overoptimism about investment opportunities, and otherwise generated the optimistic expectations on which a market economy thrives and grows.)

The striking thing today is the extent to which these three underlying beliefs of the "Full Employment" consensus are now increasingly brought into question. A subtle change in attitudes apparently began about a decade or so ago and initiated a search for a substitute policy focus. This search process has proven traumatic and stubbornly difficult. In essence, the basic three premises of the earlier policy consensus have either been rejected, or sharply challenged. In the process, older or earlier postwar priorities about the directions of economic research have also been challenged or brought into question.

Perhaps this questioning is most obvious in regard to attitudes toward price inflation. Quite clearly, price inflation today is no longer viewed quite so benignly or tolerantly as it was a few short years ago. Many considerations might explain this change. Perhaps the most basic is simply that the political sensibilities and perceptions about price inflation seem to be very different when the general inflation rate is at the double-digit or high single-digit levels of recent vintage rather than at the earlier postwar norms of five percent or less. Furthermore, current inflation fears seem little calmed by pointing to the possibility, indeed high probability, that the recent double-digit inflation experience can be largely attributed to exceptional, highly irregular forces originating mainly outside the industrial economies of the West. Perhaps this continuing anxiety about inflation can be explained to some extent by the simple fact that we really do not know much about the ways in which inflation is propagated and spreads from one sector of our economy to another.

At the Bureau, we have been attempting to fill this factual information void by preparing in-depth studies of these propagation patterns. Specifically, Avram Kisselgoff and Joel Popkin have been studying the causes of the inflation of 1964–1974, with particular emphasis on attempting to determine how it was transmitted through the economy. Phillip Cagan has a somewhat similar study underway focusing on the way in which large increases in basic commodity prices in 1973 and 1974 influenced the U.S. inflation rate during the years 1973 through 1975; Cagan has also been very much interested in whether external increases and decreases in commodity prices have a symmetrical effect on U.S. domestic inflation rates.

The National Bureau has continued its studies of the financial aspects and repercussions of inflation. Thus, Milton Friedman and Anna Schwartz have extended their historical studies of monetary trends in the U.S. and the U.K., with particular emphasis on determining the relationships between various interest rates. The Bureau has also continued its studies of the effects of inflation on financial markets and, particularly, of the ways in which investment policies of major financial institutions may be modified by inflationary considerations, the major contributors to this work being John Lintner, Thomas Piper, Peter Fortune, and Thomas Sargent.

Persistent, double-digit inflation can also create important measurement problems for economists. Not the least of these is simply to determine what the actual rate of price inflation might be. Accordingly, the National Bureau, under the project direction of Richard Ruggles and in cooperation with relevant government agencies, has undertaken a reexamination of the U.S. wholesale price index. Similarly, Robert J. Gordon has continued his work of analyzing the behavior of durable goods prices and comparing his measures of such behavior with those developed within the wholesale price indexes. Another perplexing measurement problem when inflation strikes is, of course, that of inventory valuation; the National Bureau, again in cooperation with interested government agencies, has been attempting to develop better measures of inventory values under inflationary conditions, this work being guided by Murray Foss, Gary Fromm, and Irving Rottenberg.

Just as the attitudes toward inflation have been changing, it is also obvious that the old view that economic growth is good for its own sake is not always readily accepted today. An increasing concern is expressed for the quality as well as the quantity of growth. This concern perhaps finds its most eloquent statement in environmental and demographic debates. We must clean up our air and water! Zero population growth should be society's goal! We must live within our own native or indigenous resource availability!

We at the Bureau have tried to respond to these concerns by broadening the scope of some of our measurement efforts to incorporate social as well as economic dimensions. Specifically, with the help of the National Science Foundation, we have had underway now for some years a program we call "The Measurement of Economic and Social Performance." In this research, we have placed major emphasis on attempts to expand outward from standard economic measures, particularly those embodied in the national income accounts, to incorporate dimensions previously excluded, primarily because these dimsensions have not passed through, or been subjected to, market tests. In this connection, Richard Ruggles and Charlotte Boschan have taken the lead in extending the conceptual framework of the National Income Accounts so as to constitute a better or broadly based national economic accounting system. John Kendrick has focused on the development of broad aggregate estimates of imputed values for nonmarket economic activities in the U.S. economy. Robert Eisner and associates have been working on problems similar to those of Kendrick, but within a conceptual framework they call a "Total Income System of Accounts," which focuses on the development and application of these concepts using 1959 and 1969 as benchmark years. Similarly, Henry Peskin and his associates have been working on means of incorporating environmental values and concerns into a national accounting scheme. Our present view is that we have made some progress toward better social and economic measurement with these efforts, though much remains to be done and many of the dimensions that are of particular concern to those involved in the so-called "social indicators movement" remain largely untouched by our efforts.

A most striking aspect of the increasing skepticism about the desirability of economic growth is the fact that such growth is increasingly seen as potentially harmful as well as helpful. Not only may growth mean fouler air and water, but rapid growth makes job access "too easy" and thereby reduces social discipline, or too much growth may attract too many workers from foreign places with incompatible habits and folkways. These worries, moreover, are not limited to the Swiss bourgeoisie or the Sierra Club. Much of the hue and cry about the "limits of growth" have had as their source business-sponsored activities, such as the Club of Rome. Of course, business has also pointed out that cleaner air and cleaner water and other environmental improvements are not likely to come as a free good. A good deal of controversy, in fact, has been generated about the exact extent or scale of the costs of achieving cleaner air or water and the incidence of these costs upon various groups in our society. At the Bureau, we have entered modestly into various kinds of research efforts to see if somewhat better answers might be found to these cost and incidence questions. Preliminary analyses, done by Henry Peskin, Eugene Seskin, Robert Leone, Royce Ginn and associates, would suggest that many of the early estimates of these costs and guesses about their incidence may have been over-simplified and perhaps even misdirected.

The most fundamental of the policy challenges or revisionism of the last decade is almost certainly that embodied in the growing skepticism expressed about the character and importance of unemployment as a measure of economic stress or ill-being. Recently, in fact, one hears the suggestion made, sotto voce if not openly, that there is perhaps a golden mean in unemployment as in other things, so that too little unemployment, or too much, are both to be avoided, if possible. Some economists, and others as well, would suggest that unemployment does not imply quite the same suffering today that it once did, because welfare, unemployment compensation and other governmental programs reduce its impact. Some of the Bureau's studies, particularly in the human capital area, address some of these issues, even if they do not directly answer all of the relevant policy issues involved. For example, Jacob Mincer and associates, using some newly available survey data, have been investigating the incidence and frequency of unemployment experiences for different groups in society.

Increasing uncertainty is also expressed as to whether the statistics on unemployment are as meaningful as they once were deemed to be. For example, the argument is increasingly made that we should perhaps not emphasize how many people are unemployed, as how many people are employed. Thus, it might be argued that instead of saying that the unemployment rate doubled during the recent recession, rising by more than five percentage points, we should be pleased that the employment rate (defined as the percentage of the civilian working age population holding jobs) has declined "only 2.5 percentage points" from its peak in October, 1973 of 58.9 percent to a trough of 56.4 percent in March of this year.[1] This percentage of 56.4 employed, incidentally, is also higher than the lowest employment percentage during three of the five earlier postwar recessions. Accordingly, on the basis of this measure, the recent recession, instead of being the most severe in the postwar period, as indeed it was by most measures, might de deemed one of the mildest!

Many economists, as might be expected, look at these very same employment and unemployment statistics and do *not* reach the same conclusion. Employment and unemployment ratios can both be at a high level, as they now are, if the number of people in the working age population looking for jobs is very large; that is, what the economists call labor force participation is quite high. As we all know, labor force participation has been rising steadily over time in our society, mainly because more women and teenagers are actively seeking jobs. To some economists it is a matter of concern if a historically high percentage of those looking for jobs do not find jobs, regardless of whether the number working is also high. That the business cycle recession is generated by a decline from a higher standard of well-being does not make it any less traumatic in this view. General improvement in the standard of living and economic opportunity over time is a basic and highly desirable characteristic of the U.S. economy!

In several Bureau research projects we have attempted to clarify the issues involved in making these judgments, judgments which are clearly quite subjective in basic character. Specifically, we have undertaken a good deal of work in which we attempt to obtain a better understanding of what it is that determines labor force participation and also the extent to which such participation is influenced by the state of the business cycle, government policies, and other possible influences. The National Bureau's most recent effort in this regard, undertaken by Donald Parsons, focuses on the job-search characteristics of experienced workers who find themselves laid off from their "normal" work.

Certainly a high unemployment rate coupled with a relatively lower rate of capacity utilization, such as we have experienced for the past year or so, does denote a considerable loss of potential output within our society. It is therefore striking that one of the many unmet items on the National Bureau's, and perhaps other organizations' research agenda as well, remains that of obtaining a somewhat better measure of just what the so-called "GNP gap" at any point in time might be. Certainly, the general quality of public policy has been improved greatly by the development of concepts related to the GNP gap, such as that of the full employment budget. Nevertheless, the fact remains that we really have only very crude measures of the GNP gap. I wish I could report that at the Bureau we are making great progress on improving such measures. Unfortunately, it remains on our long list of worthwhile studies yet to be done.

As already noted, though, loss of ouput and growth may *not* be quite as much a matter of concern to quite as many as it once was. This leads me to speculate whether we are not entering a new phase in our political economy, one in which the emerging consensus is to a major extent a consequence of widespread affluence. The affluent society would appear to be one in which a broadly-based middle class is dominant, a middle class extending from the higher paid blue collars through the professional and managerial groups. Affluence may also represent a state of being or bliss in which consumption, while not fully sated, is not quite as an aggressive drive as it once was. If every middle class family has two cars and two TV's, a dishwasher, a disposal, etc., further material acquisitions may wane in priority. The corollary

1. Geoffrey Moore, "Employment and Unemployment–A Conundrum," *Morgan Guaranty Survey*, February 1976.

of this is that growth for its own sake may be increasingly subliminated by this group to qualitative considerations, giving rise, as previously noted, to an increasingly widespread belief that how we grow becomes at least as important as how much we grow.

Any emerging "political economy of affluence," if true, clearly could have implications for public policy. The major policy change that might flow from such a consensus would be that the Western industrialized nations might run their economies a little less tautly than before. Thus as the economies of North America, Japan, and Western Europe come out of the recent recession, they may move very slowly back to long-run sustainable ceilings on growth. Recent efforts at the National Bureau by Geoffrey Moore and associates to improve our understanding of international economic developments should provide us with timely data to assess these possibilities.

If we do, in fact, experience slow growth out of the recent world recession, this may, in turn, generate an increased political concern with the distribution of income. No longer may we be able to evade distributional issues by saying that the "Growth Dividend" will take care of all! This concern is already manifesting itself within the economics profession by a renewed interest in income distribution. In terms of the Bureau's research program, this almost turns the clock back to day one. Concerns about the division of national wealth provided *the* major impetus to the creation of the National Bureau after World War I. The current research program continues this tradition and several projects at the National Bureau have as their major focus different aspects of the income distribution question, particularly as it relates to the full lifetime cycle of earnings (see the studies of Ann Bartel, Milton Moss, Oey Astra Meesook, James Heckman, Yoram Weiss, Lee Lillard, and others).

International distribution issues are also drawing increased attention. The "have-nots," the third and fourth world peoples, increasingly complain about their share. Many economists believe, though, that nothing usually helps the rate of development in less developed countries (LDC's), quite so much as high rates of economic development or growth in the developed nations. Among other advantages, when industrialized countries are producing at near full employment, their demands for the raw materials of the LDC's are high and their willingness to accept increased imports of manufactured goods is relatively great. There is still, though, much to be learned about what influences the development of manufacturing, in particular imports and exports thereof, in the context of underdevelopment. Research on the effect of alternative trade strategies on employment in developing countries, recently inaugurated at the Bureau, should help to more clearly define these influences; Anne Krueger is organizing and directing this major effort. Robert Lipsey, Irving Kravis, Romeo Bautista, Patricio Meller, and M. Ishaq Nadiri are working on various studies that relate in one way or another to the same issues.

Certain fine ironies abound in the current international situation. We have learned in the last couple of years that the industrialized countries of the world could handle the increase in oil prices, as generated by one relatively affluent group of LDC's, by simply cooling their economies a bit. This in turn may help these industrial societies alleviate some pressing environmental problems, justify shipping a few "guest workers" back home (whether to Puerto Rico or Algeria or Turkey) and otherwise reduce certain social and political problems, albeit at some considerable cost in unemployment and lost production. At any rate, we know today that virtually the entire increase in OPEC trade balances has been offset, not by increases in deficits experienced by the most affluent countries, but by larger deficits for everyone else. Clearly, that cannot long go on without a breakdown or revision in traditional international credit arrangements. A factual basis, though, for making a determination of the policy changes required to avoid the worst aspects of such a breakdown, unfortunately, simply does not exist. At the Bureau, a few of our recent studies (in particular, the project on foreign trade regimes and economic development, directed by Jagdish Bhagwati and Anne Krueger) should help to fill this void.

In short, changes in the goals and presumptions of economic policymaking almost inevitably have important implications for the development of economics as a science. Certainly, such changes are likely to change research priorities. For example, economists are at least marginally less likely today to develop an interest in so-called "fine-tuning" and the related art of "short-term" forecasting because of recent changes. If the political sensitivity or response curve is essentially flat between 4 and 9 percent unemployment, why bother? In general, we shall likely see a decline in the importance of macroeconomics and an expansion of micro studies. That trend, in fact, has been reflected in the Bureau's research program as we have slowly but surely shifted emphasis rather more toward microeconomics and away from macroeconomics over the last two decades or so. To take a very current set of economic policy interests as illustrative of this trend, energy and environmental issues are intrinsically micro in character. On the other hand, distribution issues involve a blend of macro and micro considerations, but with the largest and most unresolved issues being rather more micro in character.

Even within the realm of macroeconomics, a change in emphasis should occur. For example, we may become less concerned with the semantic issue of whether a recession exists since we could well be in rather long-lived states of recession or semi-recession by some measures (e.g., the GNP gap). The macro concern increasingly will be with long-term growth issues and parameters, which often can be reconciled only by a greater attention to underlying micro detail. How rapidly should the various monetary aggregates grow? How do we stimulate and expedite productivity improvement in our economy? How do we best remove the shackles from stagnated over-regulated sectors of our economy, such as transportation and equity markets, so as to restore market incentives for growth and efficiency? What is the true value of investments in human capital or educational training to our society? Do we really have a capital shortage so that we cannot finance necessary investments in productive equipment, environmental improvements, housing, etc.?

The overriding or key question lying behind all these issues is: How do we ease our economy back into a sustainable, steady growth pattern that is devoid of both inflation and gross environmental abuse? Clearly, answering this question and achieving this goal will require more economic knowledge than we now have. I am sure that many new research initiatives aimed at filling this void (like many old ones as well) will not succeed as fully as we would hope. (Developing research priorities is inevitably a "game" that involves a certain gambling instinct.) The requisite knowledge also involves larger social and cultural issues, quite worthy of investigation and research in their own right, that go well beyond the purely or narrowly economic. I would observe, moreover, that the research needed on these basic economic, social, and cultural questions will require financial help and encouragement from both government and private sources. Meanwhile, we shall try at the Bureau to adjust our research priorities and emphases to be as relevant as we can within the limits of our available resources, and, hopefully, without abandoning our basic long-standing emphasis on fundamental research.

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