Preface

In November 1999 the Brookings Institution and Yale University jointly sponsored a conference to reconsider the national economic policies of the 1960s and the theories that influenced them in light of subsequent events in the economy and of developments in economic theory and research. This volume contains the papers and comments of the participants.

The beginning of the Kennedy presidency in 1961 was widely perceived to bring to Washington a "New Economics." John F. Kennedy, as senator and presidential candidate, had sought the advice of academic economists. As president, he appeared to be more interested in economic analysis and in the ideas of economists and their policy implications than had been his predecessor, Dwight Eisenhower. This interest was reflected in the appointment to his administration of a number of academic economists. Their work was at the forefront of current research, and their views were informed by Keynesian ideas, as modified and integrated with traditional theory after World War II. But what was truly new about the New Economics was that it became a strong intellectual force in government.

As Kennedy was being inaugurated, the economy was at the bottom of a recession, the third since 1953. The unemployment rate was 7 percent, compared to 3 percent at the end of the Korean War and 4 percent at the peak of the expansion in the mid-1950s. Improving the disappointing performance of the economy was the most urgent challenge to the new administration. Debate raged as to how much of the increase in unemployment was structural—that is, attributable to changes in demographics and labor market institutions—and how much was cyclical—that is, attributable to shortfalls of aggregate demand for goods and services. Had the unemployment rate at full employment risen, or was employment less than full? The distinction was more than academic. If unemployment was cyclical, it could be remedied by federal fiscal and monetary policies. If it was structural, then fiscal and monetary stimuli to demand would be inflationary. The Eisenhower administration and Federal Reserve Chairman William McChesney Martin held the structuralist view, while the Kennedy economists thought the unemployment problem was amenable to active fiscal and monetary policies designed to stabilize aggregate demand at full-employment levels. The expansionary policies of the first half of the decade reflected their analysis. So did the policies to restrict aggregate demand that were eventually undertaken by the Johnson administration and the Federal Reserve during the Vietnam War.

Some observers today credit the New Economics and its influence on the policies of the Kennedy-Johnson years for the sustained prosperity of the 1960s, and thus regard them as an example worth emulating. Others see the legacy of those policies in the 6 percent inflation rate at the end of the decade, when unemployment fell to 3.5 percent—a level too low for stability. That period was followed by the stagflation of the 1970s. In the economics profession, the idea that activist discretionary policies could produce and preserve stability came under attack. The natural rate of unemployment, rational expectations, the new classical economics, and real business cycle theory offered powerful theoretical arguments against the economics of the 1960s, which—rightly or wrongly—was charged with overstimulating demand under the mistaken expectation that lower unemployment could be sustained at an acceptable increase in inflation.

The attempt to stabilize the economy at high levels of employment was not the only hallmark of 1960s economics. Policymakers had to contend with the dollar's evolving role in the world and its eventual overvaluation, which marked the beginning of the end of the Bretton Woods system of international financial arrangements. Tax changes were aimed at encouraging investment for long-run economic growth. And significant initiatives were taken to strengthen the nation's social safety net, including the introduction of Medicare. Thus while stabilization issues most clearly defined the decade for economists and are the subject of some papers in this volume, other papers examine developments in these other spheres—international, fiscal, and social as viewed through the lens of economics.

The conference was also a tribute to the memory of Arthur Okun, a major figure in the economic policies throughout the Kennedy-Johnson era, in Yale economics, and at Brookings. The subject matter and scope of the conference reflect Okun's interests and contributions, cut short by his untimely death in 1980 at the age of 51. Okun's public service began early in 1961, when he was still at Yale. His colleague James Tobin had become a member of Kennedy's Council of Economic Advisers and stayed in close touch with Okun. This council was trying to convince the new president and his political team of the need for expansionary policies to bring unemployment down from 7 to 4 percent. The White House was not impressed by the gain in employment from 93 to 96 percent, which JFK likened to raising a college grade from A− to A. Was that achievement worth the political cost of risking a budget deficit? The council knew that the overall economic gains that would accompany the three-point decline in unemployment were much more important than the White House metaphor suggested. In making the point concretely, Art Okun produced what came to be known as Okun's Law. Time has proved it to be one of the most reliable and important empirical regularities in macroeconomics, a signal contribution to economic knowledge as well as to practical policy. JFK committed himself to a 4 percent unemployment target. Okun soon came to the council staff, where he worked together with the two chairmen of this conference. He later became, on leave from his professorship at Yale, a member of the Council of Economic Advisers under President Johnson and ultimately its chairman.

Then, in 1969, he came to Brookings where, with George Perry, he set up the Brookings Panel on Economic Activity and its journal, the *Brookings Papers on Economic Activity*, and where he resumed his research in economics—research that reflected his trademark devotion to both rigor and relevance. Two books he wrote during the 1970s are still widely cited. *Prices and Quantities* foreshadowed many current insights in macroeconomic theory, and *Equity and Efficiency* appears on many college reading lists as an accessible analysis of a basic tradeoff that confronts economic and social policies.

Several of the contributors to this volume were researchers who were involved in policymaking in the 1960s. Their papers provide firsthand insights to the analyses and political priorities of that period and a starting point for examining subsequent policies and economic ideas. Younger scholars represented in the volume, who know that period only as a part of history, bring a different perspective. All participants have been active in economic research since the 1960s and collectively represent a wide range of expertise in applied economic analysis.

Subject to writing within a broad area, each author was free to choose the particular subject of his paper. Four of the papers concern macroeconomic stabilization and growth. William Baumol probes the heart of the capitalist growth process, modeling the relation between spillovers from innovation and income distribution and how these affect overall living standards and inequality. William Brainard and George Perry assess stabilization policies from the 1960s to the present using a model that challenges today's prevailing views of the options confronting policymakers. Paul Krugman explores why in recent years the economics profession has largely ignored the role of fiscal policy in stabilization. Robert Solow examines the model of economic growth that informed the Kennedy Council of Economic Advisers' analysis of the longer run and relates it to subsequent developments in growth theory. Richard Cooper and Barry Eichengreen each analyze U.S. foreign economic policy in the watershed period when the Bretton Woods system was coming under pressure, and relate those events to subsequent developments in the international monetary sphere. Robert Haveman analyzes the changing faces of poverty over the last four decades, and Alan Krueger examines the shifting emphasis in labor policy and labor research over that same period.

Together, these economists have provided a fitting tribute to Arthur Okun and his legacy.