

The Revolution in Economic Thinking and Practice
Remarks at the Bradley Foundation Award Ceremony
May 3, 2007

Thank you. I am very grateful to the Bradley Foundation and very honored by this award. It was as exciting to learn that I had been selected as it was unexpected. I also want to thank my family and friends who have come here today to celebrate with me on this happy occasion.

I have had the good fortune to study, to teach and to practice economics during a remarkable period. In the fifty years since I took my first economics class as a freshman at Harvard College, I have seen an unprecedented revolution in economic thinking and practice. It has been exciting to witness it and, to some extent, to participate in it.

The most remarkable such change has of course been the end of communism in the Soviet Union and in China. Those countries rejected the ideas of Karl Marx and adopted an economic philosophy much closer to that of Adam Smith.

The change in the Soviet Union was abrupt and dramatic. Today Russia is approaching a market economy and is delivering a much higher standard of living than was seen under the old Soviet regime.

When the countries of eastern and central Europe obtained their freedom in a series of bloodless revolutions they also adopted market-oriented economic systems.

The change in China has been more gradual than in the Soviet Union. When I first visited China 25 years ago, the Chinese were just beginning to experiment with economic incentives and private ownership. Although the Chinese government continues to play a significant role in guiding the economy, urban China today has a prosperous and bustling market-friendly economy. The Chinese authorities support a competitive economy and have recruited entrepreneurs and other capitalists to membership in what is nominally the Communist Party. American firms and other foreign businesses play a large role in the Chinese economy. Witnessing this transformation and the nearly 7-fold rise in GDP since 1982 has been enormously exciting.

There has also been a revolution of thinking and practice in the countries of the developing world. Fifty years ago, those countries thought they could develop with the use of elaborate planning models, state ownership of heavy industry, and trade rules that prevented imports and foreign investment. In contrast, most of those countries now recognize that the key to stronger economic growth is private ownership, market incentives, and an openness to world trade. Those who have not yet accepted such policies are lagging far behind the rapid development and growth that has transformed South East Asia and other successful developing countries.

In the United States, economic thinking and policy in the decades after World War II were dominated by a Keynesian world view that ignored incentives, thought high rates of saving would create unemployment, and called for the use of fiscal policy to dampen the business cycle. Monetary and fiscal policies were guided by

the false belief that unemployment could be reduced permanently by accepting a higher rate of inflation. The result of all this was tax rates that reached more than 90 percent, burdensome budget deficits, massive transfer payment systems that actually increased poverty, and rising rates of both inflation and unemployment that culminated in double digit inflation and an unemployment rate that reached nearly 9 percent.

Today most American policy makers recognize the importance of incentives and understand that a higher rate of national saving is needed to finance growth-promoting investment in plant and equipment. Monetary policy has generally replaced attempts at counter-cyclical fiscal policy and is aimed at promoting price stability as the best way to achieve sustained economic growth. Tax rates, although still too high, are much lower than in the 1960s and 1970s, especially the taxes on dividends and capital gains. Federal government spending on domestic discretionary programs has been reduced to just 3.5 percent of GDP and the fiscal deficit is less than two percent of GDP.

These improvements in economic policies have produced better economic performance. Inflation is now only a bit above two percent and the unemployment rate is less than five percent. Real per capita economic growth in the past decade has been substantially higher than in the previous quarter century. All of this raises the standard of living of the American people.

Why have the desirable changes in policy occurred? In a democracy like ours, changes in economic policy occur only as the economics profession changes its

views and communicates its new ideas to the public and to policy makers. That communication takes many forms – academic and popular writing, Congressional testimony, and the teaching of those who will later be voters or journalists or who will serve on Congressional and administration staffs. Institutions like the Federal Reserve, the Council of Economic Advisers and the Congressional Budget Office provide opportunities for new generations of academics to participate more directly in the policy process.

So economic policy changes occur as the ideas of the economics profession change and as those ideas become more widely diffused. By the late 1970s, many economists had abandoned their old Keynesian views as a result both of experience – especially the poor economic performance of the late 1960s and the 1970s– and of new economic analysis and research. The result has been a return to the traditional pre-Keynesian supply side policies that emphasize incentives, capital accumulation, and price stability.

What of the future? The battle for good economic policies is never over. There are always those who want to turn back the intellectual clock and return to counterproductive policies. They are always willing to sacrifice economic efficiency and growth in order to redistribute income more equally. In the extreme, some dislike inequality so much that they favor policies that will hurt those with higher incomes even when such policies would not help those who are less well off. Fortunately, such spiteful egalitarianism is rare in the United States.

It is important to continue to make progress in strengthening incentives and in revising government policies that would otherwise lead to higher tax rates and a slower growth of real incomes. The most important reform debate now deals with Social Security and Medicare, seeking ways to limit the future tax burden by developing investment-based methods of funding these programs and by focusing health benefits on major expenditures. That has been a major part of my own research and writing and it is something that I will continue in the future.

Thank you.

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