

Welcome to COWS > About COWS > Newsroom > News

## **Economy Needs Old, New**

**By: Joel Rogers**

**From: *Madison Capital Times***

**Date: 12/17/2001**

When John Maynard Keynes wasn't busy reinventing economic theory, he spent most of his life fighting one destructive economic orthodoxy or another. He argued, among other things, against the stupidity of insisting on crippling reparations payments from defeated enemies, of constraining monetary policy by tying national currencies too tightly to the gold standard, or of simply waiting out business downturns for their long-run reversal - since, as he dryly pointed out, "in the long run we're all dead."

Based on experience, Keynes concluded:

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.

What Keynes said is an enduring warning against underestimating the force of dogma, or even myth, in policy-making around the economy.

One big instance of this right now is our reading of what happened in the United States in the 1990s - what has recently been officially declared America's longest business cycle expansion, running a solid decade from March 1991 to March 2001 - the halcyon days of what many thought was a "new economy." It's very important to get straight on what this was and was not about if we are to make the right choices.

As Dean Baker, at the Washington, D.C.-based Center for Economic and Policy Research, recently summarized:

In the folklore of the business press, a widely held explanation has already congealed for the upswing that led optimists to proclaim the emergence of a "new economy." The now conventional wisdom flows as follows: Together with Congress, the Clinton administration got the ball rolling by balancing the federal budget, and moving it toward surplus. This caused long-term interest rates to fall, which led to an investment boom - especially in the high-tech sectors - and stimulated such interest-sensitive purchases as housing. All that new investment caused productivity to grow by leaps and bounds. Since productivity - the amount of goods or services that an hour of labor can produce - is the basis of economic growth, this raised incomes across the spectrum. The virtuous circle was completed by the response of the Federal Reserve: Because of the surge in productivity, we are told, the Fed didn't have to worry about rapid growth leading to accelerating inflation. Thus the Fed was able to lower short-term rates, and allow for a record-long expansion, with unemployment falling to a 30-year low of 3.9 percent.

The problem with this familiar view, which sounds entirely plausible, is that each of its key elements turns out to be wrong. In fact, real interest rates on housing dropped by less than a percentage point over the decade, not enough to fuel a housing boom, and housing as a share of the economy barely budged. There really was no more general investment boom; investment as a share actually declined. Productivity growth was up from the 1980s, but still lower than it was in the 1950s and 1960s. And when output concentrates on what the Commerce Department called NDP rather than GDP, for "net" as against "gross" domestic product - real growth in the 1990s flattens to 1970s levels, which everyone agrees were a disaster. Finally, wage growth for a typical worker was a paltry 0.5 percent a year, and that was realized by those at the bottom only late in the cycle.

What actually seems to have happened is that we experienced an enormous run-up in stock prices. The "wealth effect" of this kept even the less well off feeling better and spending like crazy. And the Federal Reserve, while not leading the boom, helped sustain it by finally realizing it could drop rates without exciting inflation - not because of massive productivity increases, but more simply because labor markets were by this point sufficiently deregulated, and unions weak, not to push wages up even in tight labor markets. The Fed could easily have done this earlier.

And the relevance of this to our present circumstance? Well, for one thing, it suggests that the \$100 billion stimulus packages Congress now is considering won't begin to substitute for lost demand. The collapse of about \$8 trillion in stock market wealth translates to about \$300 billion annually in lost consumption - so even before Sept. 11 there was a large structural drag on the economy.

\* Here in Wisconsin the relevance is simply stated. The economy of the 1990s, despite the continued advances in technology and potential productivity gain, was less "brand new" than "newer." What drove the 1990s economy, and will drive the next decade's, are familiar forces, some within the power of government to change.

It also means that the "old" economy, as much as the sexier members of the "new" one, will need to be included if we're to find general improvement. That means that it's quite possible to be in favor of high-tech and progress and knowledge and creativity and all the other good stuff the "new economy" is associated with, and still attend to our traditional sources of strength as a state, the social as well as the economic. Indeed, if we don't we won't get nearly as far as we could, right now, with what we've got. So some of the new is pretty old, and much of the old is new again. The world is round. It's time to roll.

Joel Rogers is director of COWS, the Center on Wisconsin Strategy, at the UW-Madison. COWS is sponsoring "Sustaining Wisconsin," a statewide dialogue about the future of Wisconsin.

---

Copyright © Madison Capital Times