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PAUL McCRACKEN ET AL. TOWARDS FULL EMPLOYMENT AND PRICE STABILITY

A Report to the OECD by a Group of Independent Experts
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A Review

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Towards Full Employment and Price Stability is a report to the Organization for Economic Cooperation and Development (OECD) authored by a committee of eight economists, under the chairmanship of Paul McCracken. The Committee met nine times and utilized the efforts of staff members of the OECD Secretariat. The Report contains descriptive and evaluative material on the performance of the OECD economies in the period since 1965, presented as background for a variety of recommendations or guidelines for economic policy in these countries over the decade we are now entering.

The structure of the OECD Report invites the reader to view it as the transmission to "policymakers" of a professional or scientific consensus. It begins with a 33-page Summary, self contained, and surely the only part likely to be read by its primary audience. Each paragraph in this summary references, by number, corresponding paragraphs of the 207 pages which follow, apparently intending to convey the impression that the latter provide analytical support for the conclusions of the Summary. Next come nine pages of dissents by three of the eight authors. Last come 75 pages of notes, mainly references to the technical "literature." One's overall impression is of a voluminous body of technical, scientific research being distilled for the benefit of readers who, if they lack the technical sophistication required to follow the reasoning, are at least able to understand the recommendations and act on them.

The policy objectives emerging from the study are standard, if somewhat vague: to "return to reasonable rates of growth" (p. 17), to "minimize average unemployment over the [five-year] recovery period as a whole" (p. 18), while avoiding "policies which will permit or accommodate high rates of inflation" (p. 18).

How can this be accomplished? To keep on the "correctly-judged recovery track" (p. 18) a "relatively active demand management policy may be needed" (p. 19). This policy will involve "publicly announced targets for the

growth of monetary aggregates" (p. 18), "a fiscal policy geared to a budget target designed to avoid giving an inflationary stimulus over the medium term" (p. 18) together with "a prices and incomes policy" (p. 18). It is likely that these tools will be insufficient to keep us on the correctly-judged recovery track, in which case "there may be no alternative to policies which involve more detailed intervention" (p. 19), such as "quasi-selective action to influence broad catagories of demand–business investment, housebuilding, inventories, consumption, etc." (p. 23), "additional employment in the public sector" (p. 23), "temporary subsidies to cover part of the cost of taking on new employees" (p. 29), or "vigorous steps to facilitate sectoral adjustment" (p. 29). "More vigorous energy policies are required" (p. 30). The authors also "agree on the desirability of building up security stocks of cereals" (p. 30). "Exchange rate policy may also have a useful role to play" (p. 18). This should be directed at achieving the "desired blend of flexibility and viscosity" (p. 32). Though the authors "are against going back to a formal pegging of exchange rates" (p. 31), "only time will tell how much collective management will be needed" (p. 32).

There does not, unfortunately, exist an "easy and simple formula" (p. 32) to assist those governments which are willing to take on the manipulation of the hundreds, perhaps thousands, of control variables which are implicit in these recommendations. "The right mix of policies will vary between countries" (p. 18). "Policy should be cautious" (p. 19). It should be "pursued in a pragmatic and moderately flexible way" (p. 20). Timing is crucial, so "governments should be ready to act reasonably promptly" (p. 19). Little wonder that "policy makers" are advised to "communicate and consult with one another as a matter of intelligent self-interest" (p. 30). One only wonders where they will find the time.

A curious feature of the Report, not reflected in these citations, is the fact that much of this advice is delivered in a tone of sad resignation. The term "market" is used frequently, and though it is not made entirely clear why, it appears that the authors view free markets with a good deal of warmth, or perhaps nostalgia. Thus, they are aware of "all the difficulties and dangers" (p. 19) involved in "more detailed intervention in the process of price and income determination" (p. 27). Alas, "there may be no alternative." They believe that "it is essential that full use be made of the market mechanism" (p. 30). (This followed "more vigorous energy policies are required"[!])They favor "determined government efforts" promoting "better functioning of markets" (p. 28). "This calls in some areas for the removal of obstacles to a freer play of market forces, in others for action by the authorities to supplement market signals" (p. 28). "Capital markets are generally innovative and competitive" but, of course, "regulations [are] necessary to protect borrowers and

lenders" (p. 29). Apparently, the "better functioning of markets" is also to be "pursued in a pragmatic and moderately flexible way."

The method of selective citation has its limitations, but I know of no other way to convey the Report's undisciplined eclecticism. It meanders through the long list of issues which have been defined in popular debate as "policy problems," accepting all as equally suited to treatment by government action and equally amenable to economic expertise, offering ambiguous and unsupported opinion on each. Nowhere can one discern a consistent set of economic principles underlying either the choice of questions to be addressed or the policy stances which are recommended.

As an economist, I find this alarming, but not because I believe the Report will in any direct way contribute to a worsening in economic policy in the OECD countries. On the contrary, the Report is so nearly vacuous that it will be difficult to tell which governments are attempting to follow its guidance and which are not. It is alarming because of the vision of economics it presents, to the public and to us: an economics limited to the writing of safely ambiguous lines for insertion in the speeches of treasury officials and central bankers. It is opportunism posing as pragmatism.

What is the explanation for this? This seems to me a serious question, for the Committee includes, in addition to its chairman, some very distinguished economists. Indeed, two of these, Professors Giersch and Komiya, commented very unhappily on the Report's vagueness in their individual comments. In attempting to find an answer, I found it helpful to reexamine an earlier attempt to articulate to a general audience the main themes of Keynesian macroeconomic policy: Walter Heller's 1966 Godkin Lectures, published as *New Dimensions in Political Economy*.

Heller wrote with an authority which differs so sharply from anything in the main text of this OECD Report that almost any paragraph, inserted into the Report, would stand out as if printed in red ink. His lectures convey an infectious sense of the power of economic ideas to effect fundamental changes in the way noneconomists think about economic policy. Moreover, Heller was explicit as to the *source* of this authority: His lectures were built on the "bedrock," as he called it, of Keynesian macroeconomic theory. This theory and its wide acceptance permitted him to write "of the increasing power and reliability of the tools that economists bring to their trade; a growing consensus on the analytical core of economics; lessons of performance well done that will not easily be undone" (p. 14). It is a sad but accurate reflection on the decade since, that Part I of the OECD Report is titled: "What Went Wrong?"

What went wrong, in brief, is that Keynesian macroeconomic theory failed. Only when one reads the OECD Report as a response to this failure, do the causes of its deficiencies begin to become understandable and alternative responses suggest themselves. Before developing this theme, however, I want to clarify what I mean by the assertion that "Keynesian macroeconomic theory failed."

It is not uncommon to see the modifier "Keynesian" used to mean "consistent with the observed behavior of economic time series." Brevity aside, it is difficult to see the advantages of this usage, but certainly if this is what is meant by Keynesian theory, then one cannot say it has "failed." Similarly, it seems certain that Keynes's thought will continue to stimulate economic theorists in various and unpredictable ways for the foreseeable future, so much so that many economists will think of themselves as "Keynesians." In advance of seeing these developments, one cannot presume to pronounce them failed. I am here using the term "Keynesian" much more narrowly, to refer to the multiplier calculations which all of us understood Heller to be discussing and applying, together with the underlying if less precisely specified theory which provided guidance as to the range of circumstances under which these calculations might be expected to yield accurate answers.

Briefly, the idea was to begin with a target rate of unemployment (around 4 percent in the U.S.) for, say, the coming year, and use Okun's law to find the level of real GNP consistent with this target. Standard multipliers together with short-term forecasts of private spending behavior then yield estimates of fiscal policies which will attain the target. Now it is easy to dismiss these as "easy and simple formulas," but they are more appropriately described as meaningful and operational. Their advantage over a concept like "the correctly judged recovery track" is that they provide quantitative guidance and have the property that if two different economists are asked to work out the details, both will arrive at about the same answer.

In applying these formulas, several important qualifications were understood. First, the stimulus or restraint of a particular fiscal policy could be offset by interest rate movements. An interest-stabilizing monetary policy would need to accompany the fiscal policy selected and, in view of the difficulty in forecasting other forces acting on interest rates, this policy could not be specified in advance. Second, it was understood that if the unemployment target used to initiate these calculations were too low, stimulus would result in inflation, either in addition to or even instead of, a real output response. All of this is well developed in Heller's book, and, of course, in many other places.

I want to use the term "Keynesian theory" narrowly, focusing on the

quantitative formulas which were actually used to generate policy advice, so as to be as clear as possible as to what I mean by failure. The theory failed in the sense that it produced quantitative answers that turned out to be wrong. Its *central* premises that monetary policy could stabilize interest rates and that inflation could be ignored at high rates of unemployment turn out to be sufficiently bad approximations to reality that the multipliers whose application rested on them are, quite simply, useless. This conclusion is not, I think, especially controversial and it is certainly not original. But it must be insisted on, as it is both important and difficult for us macroeconomists not to confuse the operational theory we would like to have with the theory we actually do have. In 1966, it seemed to many that we had one theory which could quantitatively link fiscal policy to economic performance with sufficient accuracy that it could be responsibly applied to policymaking. In 1977, we know we have none.

Yet in reading the OECD Report, the untrained reader would get exactly the opposite impression. Whereas Walter Heller claimed only to have a theory which could provide rough guides for full employment fiscal policy, the OECD authors appear to be in possession of a much more powerful theory, capable of dealing not merely with full employment and price stability, but with energy, agricultural inventories, exchange rates, securities regulation, and a host of other "problems," all of which they see as interrelated. How is it that the *failure* of the model on which the economic activism of the sixties was based can lead macroeconomists to offer advice on a much *wider* range of issues? The answer, I think, requires an understanding of the "conservative" role of Keynesian activism.

Whatever may be the intellectual roots of the general public approval of widespread government economic intervention, or "activism," it is clear that they antedate by far the introduction of Keynesian economics in the sense which I have sketched above. The role of Keynesian theory was to *rationalize* this activism, where I mean "rationalize" not in the sense of "apologize for," but rather in the sense of "bring order to" or "bring under rational control." The politically serious opponents of the application of Keynesian doctrine in the U.S., in the 1960s, were not advocates of fixed monetary growth rules and laissez faire; they were "structuralists" concerned about "automation," and they entered the debate armed with long lists of specific interventions in particular product and labor markets. The intended role of Keynesian theory was not to *introduce* activist policy, but to provide an alternative to a miscellany of incoherent and ineffective interventions. Heller looked forward to the time when, "if we manage to solve tolerably well the macroeconomic problem of keeping the economy moving along the path of its noninflatory potential, both President and public will have no choice but to learn their microeconomic lessons" (p. 49).

And if we do *not* solve this problem tolerably well? Heller did not say it, but the OECD Report does, with unmistakable clarity: Then we shall have to put off this lesson in microeconomics, accept the problem definitions offered us by Presidents and publics, and in the meantime do our best to persuade both that their confidence in us was not misplaced. The OECD Report represents not an extension and advance over the "easy and simple formulas" of the operational form of Keynesian economics, but rather a reversion to the unprincipled activism which Keynesian theory seemed to promise, for a brief period, to channel in a socially productive direction.

The OECD Report serves as a sobering lesson to economists who believed that when Keynesianism stumbled influence would somehow be passed to "monetarism." Indeed, some of the Report's oddest features result from the authors' attempts to digest recent monetarist criticism, to utilize it in support of a new, more sophisticated activism. The Report contains many monetarist sounding phrases, many references to "expectations," and insists (incredibly, given its "advice") that it opposes "fine tuning" in favor of more predictability in government policy. The idea seems to be that one can somehow synthesize Keynesian and monetarist views into a new framework as operational as that within which Heller operated. The fact is, however, that no one has worked such a synthesis out, and this fact shows, in lines like: "Governments can and should help to promote healthier expectations" (p. 19). The modern activist demand manager is in the position of a motorist lost in Illinois but possessing only a roadmap of Pennsylvania. It is no help to say: "Well, we must just modify our map to fit Illinois." The sentiment is attractively upbeat and "constructive," but it makes no sense.

The failure of this attempted synthesis to yield a coherent policy program is not, I believe, a reflection on the analytical abilities of the McCracken Committee but of the intractability of the problem itself. Professor Komiya puts this (and much else) clearly in his individual comments: "Dynamic optimisation in an uncertain world requires constant adjustment of the trajectory, as with rockets and satellites" (pp. 250-51). "For example, a statement such as 'the general case for "feeling one's way" along gingerly is rather compelling' is not acceptable to me. I believe it is most important that the medium-term targets themselves be revised frequently, taking into consideration latest developments which are to some extent different from what was predicted earlier" (p. 251).

The predictability obtained by the "public announcements of targets for the rate of growth of the money supply" (p. 20), desirable from a monetarist point of view, is both immaterial and undesirable from a Keynesian point of view. From a modern Keynesian viewpoint, target unemployment rates, interest

rates, and inflation rates can be maintained (and hence made predictable) by constant adjustment of policy instruments to new shocks. Of course, this means that the policy instruments themselves will be unpredictable, but what difference does this make to anyone? The clarity of Komiya's remarks stems from the fact that he is working within an internally consistent (Keynesian) framework, and is willing to accept the policy implications which follow from it.

From a monetarist point of view, price stability and predictability *are* important, and are approximately attainable under a well-chosen and predictable monetary growth rule. On this view, unemployment and interest rates are unpredictable, and this is accepted as a fact of economic life, curable only at a prohibitive cost. These two views of the world are mutually incompatible, and lead, therefore, to quite different recommendations for policy. The McCracken Committee has tried to compile a program by taking some objectives which are desirable and attainable under a Keynesian view and advocating Keynesian policies to attain them. It has taken a few others which monetarists claim to know how to achieve, and advocated monetarist policies to do so. The hope, I suppose, was to please everyone, but the inevitable result was a report full of contradiction, partially but not fully hidden by ambigious language.

It seems certain that economic policy in the OECD countries in the coming ten years will involve a wide variety of government interventions in particular sectors and industries. The particular interventions which emerge will, looked at in the right way, presumably exhibit some pattern. (For a social scientist, this much must be taken as an article of faith.) The chances that it will be *economic* theory which provides coherence to these policies must be judged, however, to be near zero. In these circumstances, the McCracken Committee is attempting to create the appearance that economic advisors are technically in control of developments, guiding them in a spirit of flexibility and pragmatism, supported by the technical research efforts of an entire profession.

Yet is it in the interest of economics that these political developments be viewed as being supported by a consensus of professional opinion? The main reason to answer in the negative, stressed in this review, is also the simplest: it is not true. There is also a second reason, of a more "pragmatic" nature. There is every reason to believe that the economic policies of the coming decade will, being guided by no economic principles, lead to very bad results. What can be the benefit of claiming for economic theory the blame for a collection of policies which in no way follow from it?

References

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