



Policy Note

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Is the New Economy Rewriting the Rules?

Remarks by James K. Galbraith at the White House Conference on the New Economy, April 5, 2000

Mr. President, the question before this panel is, in effect, "Can full employment without inflation endure?"

According to the "old rules" and those who believe them, the expansion will not last. Growth is too rapid, unemployment too low, stocks too high. There are deep and mysterious reasons why wage inflation is sure to explode someday soon. Even more mysteriously, some have even suggested that the rate of productivity growth is too fast.

A second view holds that the New Economy has changed the rules, cutting costs and creating opportunities that never existed before. In part, this is surely correct. The new technologies are today contributing about 8 percent of employment and 35 percent of growth, the Commerce Department reports. They are important, but they are not the whole story.

A third position is that the old rules were wrong all along. This viewpoint, which I hold, is that, for the first time in 30 years, we are now seeing the fruits of full employment.

Many economists have lived for decades in fear of full employment. They imagined hidden terrors, like runaway inflation. They did not sufficiently listen to those few, like the great Robert Eisner, who taught that the real rules aren't so grim. Eisner taught that growth could raise wages and yet also spur investment and productivity, in effect, that full employment in the Old Economy would bring the New Economy to life.

Mr. President, the historic merit of your administration--and of Mr. Greenspan--was to put this proposition to the test. *And now we know.* In every year since 1993, unemployment has fallen and real growth has exceeded speed limits widely announced in advance. In almost every year, productivity has accelerated. Now we know.

Many also fret that today's prosperity was purchased by high inequality and particularly that information technologies are inequality producers. But, in fact, since unemployment fell below 6 percent, pay gaps have narrowed. Improvements so far are modest. Still, the movement is in the right direction. Today we know that rising pay inequalities are not a price of progress, nor are they a social cost of full employment.

Let us therefore set aside shopworn worries and the self-immolating doctrine of the preemptive strike. If there is a ceiling for growth or a floor for unemployment or a limit to this expansion, the truth is that no one knows where it is. Why borrow trouble? Why not take a positive view? Full employment and strong growth are great achievements. Let us celebrate and defend them. Let no one say that the unemployment rate is too low. And especially let no one say that the productivity growth rate is too high.

Are there dangers? Yes. However, inflation, apart from oil prices, is not one of them.

High interest rates are a danger. American households have too much debt. They will become vulnerable when interest rates rise.

Stock market speculation is a danger. Margin lending is exploding, and those loans will be exposed if stock prices decline. Some of that is already happening. Rising interest rates and speculation on credit are an explosive mixture.

In my view, excessive budget surpluses may also come in time to pose a danger. Too much taxation and too little public spending weaken private disposable income; economists used to call this "fiscal drag." For this reason, I do not favor rapid reduction of the public debt for its own sake.

Can the dangers be managed? Yes, they can.

We can offset household debt burdens, and the declining personal saving rate, by raising wages and family income. We should raise the minimum wage, expand the EITC as proposed, and support collective bargaining. On average, earnings should keep pace with productivity--a bit more at the bottom, a bit less at the top. We should also modestly expand public services--education and health care and the environment, I would urge, rather than defense--and even consider

modest tax relief, carefully targeted and carefully timed.

For its part, the Federal Reserve Board, instead of setting off to fight an inflation that is a pure product of academic imaginations, could control margin lending. Raising margin requirements is the direct approach to a stock bubble, more targeted than raising interest rates and more effective than jawboning the lenders. If a crash comes, sooner or later, a failure to have acted on margins will weigh on the record, and not for the first time.

But a crash need not come. Despite the nervousness of the markets, these are good times. With the right leadership, with prudent policy changes when they are needed, and with cooperation from all branches of government, the good times can endure. We can continue to grow and prosper, to enjoy full employment and strong productivity growth and a rapidly expanding New Economy. Not forever, but for another four, another eight years into the future. Yes, we can do that. And we should.

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