Defending the Clinton Administration

Interview with Joseph Stiglitz

President Clinton's former chief economist defends the administration's pursuit of a middle road between the economics that characterized the New Deal and the Reaganomics of the 1980s. He talks about advocating a similar agenda in his new position at the World Bank.

Q. What do you think the main economic achievement of the Clinton administration has been?

A. As I wrote in the Economic Report to the President, there are two accomplishments we are proud of. The first is the attempt to articulate a new economic agenda for the Democrats that is somewhere between the New Deal and Reaganomics. On the one hand, we must acknowledge that the world has changed. The kind of strong government intervention associated with the New Deal is clearly inappropriate now. On the other hand, Reaganomics led to its own problems—such as deregulation. To a large extent, the banking crisis of 1989 was related to regulatory lapse. Maybe more important, the implicit assumptions of trickle-down eco-

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nomics and social Darwinism clearly have problems for the long-run strength of the country. Arriving at an economic philosophy that lies between these two represents an achievement in the sense that it lays a new course, a direction for our time.

Q. But what are the explicit limitations of a New Deal philosophy in this age?

A. The New Deal underestimated the powers of the markets, the drive for efficiency, and the drive of markets toward innovation. It was passed at a time when there were severe doubts about capitalism and when the economy was in a depression. One out of four people were out of work. It was obviously hard at that time to say markets always work.

Q. Do you think there was a case to be made that markets weren't working?

A. Exactly. At the time of the New Deal, the case that markets weren't working was fairly compelling. But we live in a different era today. Between 1950 and today, markets have brought some great advances, such as innovations, increases in the standard of living, and increases in per-capita income. After World War II, underconsumptionists were really worried that the economy would slip into a permanent recession. The fact is that, by and large, the economy has done very well over the past fifty years. We had a recession from 1981 to 1983, and we had a much smaller recession in 1992, but the economy recovered and has created an enormous number of jobs. So, it's even weathered the process of downsizing.

Q Let's talk about that. Economic growth and the rate of productivity growth in the 1970s, 1980s, and 1990s have not equaled the rates during the immediate post–World War II period. And economic historians claim that the current rate of growth has not even equaled the average rates since 1870.

A. First, even moderate productivity growth accumulates over time to make a big difference. Even the 1.1 percent rate of productivity growth that we have had since 1973 adds up. This is far better than the stagnation that non-market economies often experience. Second, the growth of the 1950s and 1960s was partly the result of trends that occurred during the 1930s and 1940s. The 1930s and 1940s were unusual in two ways: The 1930s were a period of very low investment, and in the early 1940s, during the war, there was an enormous amount of government-sponsored research as part of the war effort. So the 1950s and 1960s were a catch-up period, with innovations such as jets and nuclear power, many of which were driven by the war and some of which were delayed because of the Depression.

The more relevant comparison requires broader vision. In regard to this, one has to recognize that we have an increasingly serious mismeasurement problem. We are not capturing the growth of productivity in our society or in our economy. Evidence of this is that the measures of productivity in the financial sector show basically no increases over the past decade. So although bankers and financial groups have been working hard and investing enormous amounts, and they all believe that there has been an enormous productivity increase, it's not showing up in the data.

Q. A lot of people argue that point with you. In the recent Economic Report to the President, however, you did not make such a firm claim that productivity was not being captured. You stated it more carefully.

A. It is difficult to say for sure what the magnitude of any mismeasurement is. The report did have a whole section on the measurement problems, such as the recent difference between measures of gross domestic income and gross domestic product (GDP). They are usually about the same. In the third quarter of 1996, growth in gross domestic income was more than 4 percent

and GDP was 2 percent. That's a huge gap. And of course it is equivalent to a gap of the same magnitude in productivity. Looking at the income rather than the product data gives you a very different view about whether we are above trend or below trend.
Q. Or at trend. What you determined is that we are still at trend—that rather low trend since 1973.
A. On the basis of measured productivity, we cannot be sure that we are at the same level trend. My judgment is that we are mismeasuring productivity.
Q. But do you think the mismeasurement can account for more than a couple of tenths of a percent a year?
A. You're right. It doesn't close the historical gap between the past twenty years or so. But the trend line could be substantially higher than the 1.1 percent.

But to come back to the major theme, a moderate rate of growth is still better than stagnation. And the market economy has been able to deliver standard-of-living increases year after year. The New Deal underestimated the power of the market in this continuing process of innovation.

Q So what are the key elements of a strategy that walks the middle line between the two?
A. I would emphasize fiscal responsibility, which is reducing the deficit, and a more market-friendly view, evidenced for instance by the telecommunications bill that tried to open up the market to competition. This wasn't simply naive deregulation; there are still elements of natural monopoly in this market. This bill represented the right kind of balance. It said we could have a lot more competition. We could roll back the role of government enormously, but rolling it back doesn't mean stripping it of all power. Similarly, in bank regulation, we could maintain effective regu-

lation, while making it more efficient. Again, it would be unwise simply to deregulate banking and eliminate prudent regulation. We had that problem in the 1980s.

Q What do you think accounts for the recent five to six years of economic expansion? Were the reduced interest rates resulting from lower deficits the most important factor?

A. Yes. What would the level of business confidence be if the United States had a deficit of $290, $300, $350 billion—and it was estimated to reach that magnitude. People would have thought that the U.S. government was not functioning well and was not able to address the nation's key economic problems. That, in itself, would have led to high levels of anxiety. A high level of anxiety would have depressed investment. Businesses would not have been as willing to undertake risky investments. The increase in business fixed investment has absolutely soared. It's been at double-digit rates—40 percent a year in real terms—for more than four years.

Q. On a net basis as a percentage of GDP, however, is that an impressive level? Is depreciation taken out of that?

A. I don't have the numbers in front of me, but the rate of increase is still impressive compared with the previous investment expansion. The aggregate investment data during the Reagan era was not that bad. But a disproportionate amount of that went into building commercial real estate, which was left vacant and helped lead to the debacle of the late 1980s. As a result, what you had is an investment expansion that was based not on fundamentals but on misguided tax distortions.

Q Isn't the current investment wave too focused on the latest fashions in computer equipment and too short term in na-

ture?
A. Well, I have to believe that the businesses that are investing their hard-earned money are best able to judge what is likely to yield a high return. Obviously, their views are subject to changing whims. But, at the same time, most businesses believe that if you don't invest in modern technology, you won't be able to keep up. Investment in computers then becomes a question of survival in the modern era. The pace of change is so fast that if you don't have the technology, you won't be able to survive.
Q. We've had plenty of investment fashions in the past that proved to be valuable to a degree, but many eventually got carried away.
A. Obviously, one can overinvest. There have been overinvestments in pizza parlors and many other industries. This is a little different. This is really changing the way businesses operate. The full fruits of these changes will be realized in the future.

But, to return to the productivity increase . . . Manufacturing, which is the one sector we probably have the best data on, has been increasing at 3.5 percent during the past four years. This is more evidence that we may be underestimating productivity increases elsewhere in the economy. This is also consistent with the view that investment in technology pays off, because a lot of computer technology has been introduced in manufacturing.
Q. But even the economist Robert Gordon, who has done some recent work on manufacturing, suggested that the manufacturing productivity data may be exaggerated because of contracting out and other factors. And of course the manufacturing sector has been growing very slowly, so there could be a selection process. The industry is so subject to international trade that only high-productivity industries survive.
A. Manufacturing employment has been decreasing, but output has not been that bad.
Q. But it has been growing more slowly than an already slow-growing economy.

A. Actually, contracting out would not make a difference, except that there are measurement errors in the parts that are contracted out. That's an issue of partitioning the productivity growth between different sectors, but not whether the economy itself is doing well overall.

Q Let's discuss the basic measurement of how well an economy is doing: What people earn. We haven't had much growth in family income, especially compared to expansions of the 1950s and 1960s, or in the employment cost index and other measures of wages. Are you satisfied with that rate of growth?
A. Obviously, we would like real wages and real incomes to grow faster. They have been increasing: Median family income increased 2.7 percent in real terms in 1995.
Q. But they are barely at 1989 levels.
A. That's right. We have not recovered the lost ground. But there are two points here, and one of these you won't agree with. The deflator—the measure of inflation—is wrong. We may disagree about the magnitude of the mismeasurement and we may disagree about the quality of evidence that was brought to bear to make the argument, but most people who have looked at this feel fairly confident that there's at least some bias. If there is a bias, it gives you a slightly different view of how fast incomes have been rising.

The second point is that wages generally track productivity when wages are deflated by a broad output deflator. What happened over the past few years is that there's been a change in the relative price between consumption and capital goods. The result is that the wedge between the consumer price index (CPI) and the gross domestic product (GDP) deflator was unusually large. There's no reason to believe that will continue. When the CPI and the GDP deflator are more alike, real wages as we mea-

sure them will start tracking productivity once again.
Q. Nevertheless, family income has been growing pretty slowly. Will that change?
A. My forecast is that family incomes will grow more rapidly because in the future there's every reason to believe they will track productivity increases. There is even reason to believe productivity increases may be expanding. So, at the very least, the forecast will be 1.1 percent. But if the current income measures turn out to be more accurate, productivity over the past three or four years has been growing at a rate of around 1.4 or 1.5 percent. So we should expect to see real wages increasing by a commensurate amount.

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Q. Is it possible that reduced unionization—more bargaining power that's shifted to the side of business—and those kinds of institutional factors have kept wages down?
A. There is some evidence that those types of factors have contributed more to the widening of wage distribution than to the average level of wages. The evidence is that real wages deflated by an output measure have tracked productivity, which is what they did before these institutional changes. So there is no evidence that those factors have a very large impact on average wages.

Q Another way to look at what's going on in the job market, of course, is job stability, displacement rates, and whether good

jobs are being created. Have you been disappointed by the progress made in the expansion in those areas?
A. To some extent. What I really care about is that people who lose jobs get new ones. The key variable is not the gross displacement rate, it's really the unemployment rate. And we've done very well on the unemployement rate. It's come down from more than 7 percent early in the 1990s to just more than 5 percent and that is very impressive given that inflation has not increased. Obviously, we'd still like to do better. If anything, people have been pleased that we've been able to have low unemployment without inflationary pressures. The pace of gross job displacement, in

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fact, is going to be affected to some extent by the pace of innovation in the economy and the level of industrial conglomeration. When you have very fast-paced innovation, you're going to have more displacement. We may currently be engaged in a faster-paced period of innovation, so this displacement may not be a bad thing. In a very large company, jobs may be destroyed in one part of the company and created in another. People move from one part of the company to another. What's important is life-time employability, that you have the ability to move from one job to another. This movement from one job to another, from one firm to another, is in part a consequence of the evolving new industrial structure.
Q. You have argued that we are creating better jobs. What is the evidence of that?
A. The Council of Economic Advisors divides the economy into 990 occupational categories and industrial classifications. We

then ask what areas in the economy, what occupational industrial categories, have expanded. Are those high-wage or low-wage categories? The data showed that 68 percent of the new jobs being created were in categories that paid above-median wages.
Q. Was there a historical benchmark? Was it 50 percent in these high-wage categories in some earlier year?
A. We did not do the historical benchmarking ourselves. Other people have looked at previous periods and have found that this is a far higher rate of jobs creation in higher-wage categories than has been the case previously.
Q. But we don't know whether the median wage continued to be high in those categories or what the new jobholders were being paid.
A. We could look at the median wage in these categories, both before and after. That hasn't changed a great deal. These are the above-median categories, such as nursing or computer programmers. The problem is that there is no way of tracking wages while some jobs are being created and others are being destroyed. The total number of new jobs in the economy was very high—about 11.5 billion net new jobs, and determining the wages of the new jobs is not really meaningful because job titles change all the time.

What we do know is which categories are being added to—where in the economy new jobs are being created and where new jobs are expanding in these high-wage categories. That's what we know.

Q In the Economic Report to the President you discuss the inequality of income. What has happened to inequality in the past couple of years?
A. We know that during 1994 and 1995 inequality was reduced markedly by some of the standard measures. We know that, for instance, all quintiles in the population experienced economic

growth—growth in real incomes—and that the lowest quintile had the fastest rate of growth and the next lowest had the second-fastest rate. Again, these changes have not undone the huge increase in inequality that occurred over the previous two decades. And two years of data will not give us enough information to be confident that there's been a reversal of the trend.

Q What remains to be done by this administration?
A. We have made enormous progress toward reducing the deficit—bringing it from 4.9 percent of GDP when we started to 1.4 percent. I feel confident that we will be able to get a balanced budget agreement that will bring it down to zero. The real issue that we highlight in the report is that, given the aging population, unless something is done about social security, Medicare, and long-term nursing care in the Medicaid program, the deficit will again start to increase. We will have to make serious reforms in these programs to restore them to financial viability and at the same time preserve what have been very effective programs. Social security has succeeded in reducing the poverty rate among the aged from a level that was much higher than among the population as a whole to a level that is lower than among the population as a whole.
Q. Politically, can this be done?
A. Yes, I think it can. The reforms are important if we want to preserve these programs, and advocates of the programs recognize this. Something will eventually be done because of the inevitability or the high probability of a fiscal crisis. And so the question is, do we do it now or wait until the crisis is here?
Q. Are you discouraged that not enough is being done now?
A. It is important that these reforms be done in the context of a consensus. To be effective in democratic processes you have to reach a broad agreement. During the past four years, there's been

considerable movement toward reaching that agreement. There's been an increasing recognition of the problems.

Q. The Medicare problem is ultimately much bigger than the social security problem.

A. Yes, but it's bigger and also more complex. It involves more difficult analytical and economic issues. In a sense social security is just about money. Medicare involves the provision of an essential public service to a huge portion of our population. Medicare reforms will affect how those services are delivered and the cost of those services. It affects the very nature of what we're delivering. I feel very strongly that the sooner we handle the problem, the better. The longer we wait, the more drastic reforms will have to be and the less support there will be for those programs because there will be less confidence.

Q By worrying so much about balancing the budget, are we neglecting needed public investment that could raise productivity?

A. The key issue is balancing the budget while maintaining those priorities. The question is whether we have done enough, over the past 100 years, to preserve certain priorities, such as education, infrastructure, or research and development—our technology infrastructure.

Q. Is it likely that we will be able to avoid a recession over the next few years? Many of the achievements you describe, from reducing the deficit to improving the distribution of income, could be reversed in a recession.

A. Do expansions end of old age? The answer is clearly no. The probability that an expansion ends is basically constant per month, independent of the age of expansion over the range for which we have data. So, there is no higher likelihood that we will enter a recession in the near future than there is at any other time.

In fact, quite the contrary. I would say that a very large proportion of economic downturns have been caused by monetary policy stepping on the brakes too hard in the face of inflationary pressures. We don't have any inflationary pressures right now, so I don't see any potential for a downturn. Our economy has become more diversified, and we don't have any excess inventory buildup. The fundamentals of our economy are very strong right now.

Q You are now stepping from a national scene to an international scene as the senior economist of the World Bank. Do you have an agenda?

A. Yes, the search for a middle way. That is essentially what many of the less-developed countries are striving for. They believe that there is an important role for government, of course, but that the center of economic growth has to be the market. Finding the right balance—the same balance we've been striving for in the United States—is exactly what they are striving for. The answers will be different in those countries because the situations there are different, but the basic philosophy, the basic economics, is similar.

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