- Welcome to another in a series of commentaries on the current economic scene. Our guest again this week, for the week of February 10th is Professor Paul Samuelson of the Department of Economics at the Massachusetts Institute of Technology. Professor Samuelson, what has become of the new economics, is it now old hat?

- I don't think that the the new economics is obsolete. It's interesting to read in the newspaper various eulogies and epitaphs for the late departed, the new economics. I think what is clear, unmistakably, is that the people have spoken at the polls and we have a new set of economists in the new administration. But if I honestly ask myself what the difference is between the new economists and the new administration and the old economists and the old administration, I don't come up with the same answers that I read in the popular press. Let me try to enlarge upon this subject. First, there is, of course, something of a difference in general philosophy of the republican party and the democratic party. This shows itself in something of a difference in philosophy of the new republican president and the recent democratic presidents. I don't want to expand upon that theme, it actually is quite complicated to delineate what those differences are, but it's not necessary for my present purpose to do so. A new man in office, of course, picks his own people and he picks his people from those who are eligible to be picked, generally, by him. I don't say that a republican president doesn't occasionally pick a democrat so that his administration can tap all the talent that's available and so that it can seem to be somewhat bipartisan, but by and large, there is a panel of economists who are known not to be democrats and it's from this panel that the new administration tends to pick. Now, in order to belong to that panel, you must, over the recent years, have behaved in a certain way and have had certain attitudes, so it's fair to say that most of the economists on any typical panelist of republican economists are, philosophy somewhat different from those of the old establishment, a la Kennedy and Johnson. The words right and left almost came to my tongue. I will use them as shorthand but with the understanding that right and left have not quite the same meaning that they have had in the history books and that they have in some continental countries. By and large, the people who believe in more limited government, in less government intervention, in a smaller role of the public sector in comparison with the private sector have historically belonged to the republican party and they still do and so you have that particular difference. Now, such a difference is a difference in degree, if you like, you can make into a difference in kind but I don't think that that difference constitutes the difference between new economics and old economics. I won't purport right here to try to formulate a definition of exactly what constitutes the new economics but a minimal definition would include a considerable emphasis upon the modern theories of income determination which give fiscal policy an important role in the estimation and control of total aggregate demand. This is a movement which began in the early 1930s, already 35 years ago, its greatest impetus was in the 1936 general theory of John Maynard Keynes and it has gone through a certain amount of evolution and development so I will simply call it the post-Keynesian orthodoxy. It's, by all head count, the predominant orthodoxy in the academic textbooks and in the academic community generally. Your humble servant, now speaking, I suppose, is a pillar of that particular establishment and if you were to look at the most recent edition of my elementary textbook, Economics, which is in its 7th edition, you would find embalmed many of the analytical notions and preconceptions of the new economics. Now, the new economics is an evolving thing. There are many differences between the first edition of my Economics textbook of 1948, a little over 20 years ago many differences from the 7th edition and I'm now busily engaged in preparing the 8th edition which will, most assuredly, be different. But nevertheless, a man has only one life to live and my readers would be greatly surprised if, in the 8th edition, I sloughed off all my previous skins and turned out to be a pre-Keynesian economist or an anti-Keynesian economist and I can give advance notice or warning or prediction that, in fact, in the next, newest edition of my book, the brand of FAB, which is better than the old FAB, even, there will be a heavy emphasis upon public expenditure as a predictable determinant of aggregate total money demand. In that book, the prospects for over-inflationary exuberance will be much affected by a too-high level of public expenditure. That exuberance will be controllable and limitable by, other things equal, a reduction in public expenditure. In the new edition of the book and in the tenets of the new economics, an increase in tax rates will be postulated to have a definite and predictable effect upon aggregate demand. In that new edition of the book, there will be chapters, many of them, dealing with monetary policy. And changes in the stock of money will, other things equal, have a predictable effect upon the state of aggregate demand. If you look at the first edition of my book and look for the role of money and if you compare it with the 7th and with the new 8th edition, you will find that the important of money has been vastly increased. This is not necessarily a post-Keynesian change or an anti-Keynesian change because, as students of the subject know very well, John Maynard Keynes himself never gave up the notion that if you could bring longterm interest rates down by aggressive monetary policy, you would have substantial effects upon the level of total spending, upon inflation, upon the level of unemployment. So Keynes himself was, in part, what is today called a post-Keynesian. Now that doesn't mean that all of the Keynesians of his time held that view. There was a narrower, deep Depression version of the Keynesian system which pooh-poohed the role of money. That has not been true, that was not true, by the way, in the form that I've described it, of my first 1948 edition, it has not been true of any edition but the role of money has steadily increased. Well now if we use this analytical definition of what constitutes the new economics, and I may say that this particular version of the new economics could not be found in the textbooks and in the writings of economists, prior to 1930. I don't say you won't find a foreshadowing of it, here or there, but every historian of science knows that a brief glimmer of, say, a Newtonian truth, is not to be regarded as a genuine precursor of that particular message. Now, that generally constitutes the new economics. Now what was so very new in the 1960s was that, for the first time, the official apparatus of government, the prince, if you will, became converted to these particular ideas and these particular ideas were put into effective practice. This had been done in other countries and I may say with very great success, in my judgment, earlier but had been done only piecemeal and grudgingly in our own country, prior to 1961. So on the whole, if I were to give a non-technical definition of the new economics, I would couch it not in terms of innovations of economic analysis and theory but of a change in the effective know-how of government in our mixed economy democracy. The people insist upon a very high level of employment. They are more callous with respect to the risks of inflation than used to be the case in the 19th century and they are determined to have government use these new tools. Now, if that is my definition of the new economics, it's not the only possible definition, I would say that there has not been a great seat-change in Washington. I do not believe that Paul McCracken or Herbert Stein or Hendrick Houthakker, the three members of the Council of Economic Advisers, will go from the new economics back to the old economics. I do not believe that Arthur F. Burns will go back to the old economics. I believe that Arthur F. Burns, in 1953 to 1955 was, in a less activist way, using the new economics, both with respect to fiscal policy and with respect to his urgings on monetary policy. Now, I'll comment upon some differences in methodology in a moment but, to a first approximation, I think that there is where the truth lies. Now how do I reconcile this with the fact that one, there does exist a challenging ideology, if you like, within the field of analytical economics, namely that of the Chicago school or, if that is too broad a description, let me be more specific and identify this with the view of my colleague in this series and my old friend of more than 30 years standing, Professor Milton Friedman. Professor Milton Friedman is not a post-Keynesian in the sense that I have described. I think that he would argue that his position, his present position, has been very little affected by the Keynesian developments and that he would be where he is now if Keynes had never lived, if Keynes had never written. I'm not an expert on this particular topic and so there's no need for me to go into it. Now there are certain elements though, in the analysis, which Professor Friedman has arrived at independently of the post-Keynesians, which coincides with the views of the post-Keynesians and I think for this purpose, I had better be specific and mention two particular people because they are prolific writers, very well-known to economists, although perhaps not so well-known to many of my listeners, if you are bankers and investment people, students, although the teachers among my listeners will know the names very well. I refer to Professor James Tobin who was a sterling professor of economics at Yale University and to my own very distinguished colleague at MIT, Professor Franco Modigliani. If I write down the things that Professor Friedman believes about the demand for money and if I write down the things that Professor Tobin, Professor Modigliani believe about the demand for money, there is a very great overlap. An example would be Professor Friedman's statement of his views in the new International Encyclopedia of the Social Sciences. Except for a final paragraph or two, which in my judgment do not necessarily follow logically from anything that was said earlier, or from the general drift of what was said earlier, there is little in Professor Friedman's statement of the demand for money, the factors upon which it depends and which he enumerates in that article, which include, by the way, the rate of interest that Professors Modigliani and Professor Tobin would not agree with. Now mind you, I presume that when Professor Friedman wrote this article for the International Encyclopedia of the Social Sciences, it was not his purpose to give a statement of his views emphasizing their differences with those of economists generally. On the contrary, perhaps he properly felt it his duty to give a balanced survey of the field and, in a sense, such a survey tends to play down the differences in opinion. Well, there is this very large overlap. Now I expressed my own views very candidly. Where Professor Friedman overlaps with Professors Tobin and Professor Modigliani, I agree with him. My view is very similar. Where he differs, and I think these differences become very important for policy, I don't agree with them, Professor Modigliani doesn't agree with them, Professor Tobin doesn't agree with them. Now, the question that I would like to ask is where we find this difference. Does Paul McCracken agree with him? Does Herbert Stein, does Arthur Burns? I think in these matters you must judge people by what they say and you must also judge people by what they advocate and Paul McCracken has, many times in recent years, gone on record and said that he has become more Friedman-esque and to me, that is perfectly compatible with his now being convinced of the truth of those ideas which Professor Friedman has in common with the post-Keynesians. I doubt very much, I'm not privy to the private councils of new administration but I doubt very much, when Mr. Nixon held a meeting with his new economists, that is, his new new economists on what his attitude should be towards perpetuation of the surtax, I will bet a penny that if I could have been a fly on the wall, that there would not have been, forcefully represented at that meeting, by McCracken and Burns, the view that the surcharge maintenance does not matter, as far as the control of inflation in the middle of this year is concerned. Now let me make very clear the ground rules of this discussion. I am concerned that extraneous matters not complicate the differences in viewpoint. So I wish to specify that the view of McCracken, I've studied very carefully all of his writings, seems to me not to be compatible with the following, if you hold the rate of growth of the money supply constant and if you are concerned with the total of the aggregate demand, I do not believe that Paul McCracken is of the opinion that lowering taxes, in that situation, would not be inflationary or inflationary in comparison with what would have happened. Now I won't cite chapter and verse of just which writings of McCracken in the recent past would have to be referred to in this regard but I'm giving you my measured opinion in this matter. And let's make no mistake about it, because you've heard this on your tapes and if you read the last edition of Newsweek, that Professor Friedman, as a result of his studies, is very definitely convinced that a change in the tax rates, as he said in a very recent tape, if you control the money supply constant and if you make the separate allowance for the change in our potential GNP that comes from the change in mix of the public and private sector and capital formation versus consumption, it has no other effects upon the state of aggregate demand, that is, no other predictable effects. In other words, Paul McCracken, in all of his writings and views and Arthur Burns does not act as if he believes in the finding of the November Federal Reserve Bank article, which econometrically determined the tax rates have no independent influence upon the state of aggregate demand. I could go on with respect to public expenditure, but it's only necessary for the present purpose of defining whether we really have a substantial group in government who have turned their backs upon the new economics to stick with the more clear-cut case of tax rate changes. Suppose I am right in this view that, essentially, the same analytical apparatus of the new economics is the model which guides the thinking of the Nixon advisers, how are we to account for the fact that we read, in the press, that the new economics is dead. I account for that sociologically. I think there is an absolute need for a differentiation of product. I may say that I'm perfectly prepared to go along with the gag and to encourage this talk because what I want is rational economic policy. And if rational economic policy, let's say in the field of agriculture, gets contaminated with the name of somebody called Brannon, so that to call a thing the Brannon plan is to kill it politically, then I would hope very much to have it called the Ezra Benson plan and brought back into existence. Or to be called the Clifford Harding plan or to be called the Richard Nixon plan or whatever good name of the moment is needed in order to make this excellent plan viable in the political environment. Could you imagine Paul McCracken taking office and saying, I take office with the full cognizance that the people whom I follow were exactly right in their general model of thinking. To me, that would be absurd. It would be absurd changing roles for a new Kennedy, let's say Edward Kennedy people in 1972 to come into office and say, gee, that Herbert Stein really had things exactly right and we intend to do more of these very good things in our administration except we'll do them even better. It's politically necessary to differentiate your product, adjust as it's necessary for Marlboro cool cigarettes to be differentiated from Winston's hot cigarettes. So I think that there's a certain amount of unconscious, non-Machiavellian window dressing of this particular kind that goes on and I say more power to it. I may say, I'll comment in later tapes, about just how the new team seems to be doing, once specific economic action becomes more discernible. But as an observer, I've become convinced that sometimes change is a good thing. I mean now, from the standpoint of a person who believes in a very active role for government, I'll put that cap on my head for the present discussion, I think that many things that will involve an expanding scope and role of government in directions that are needed can only take place when one party goes out and another party comes in. That's the way I think the evolution of the system proceeds.

- Professor Samuelson, you promised to comment on the methodology of the Conference Board Forecast. Would you do that now?

- I will very briefly, in signing off. I appeared on a program in New York, a week or so ago, before 2,700 investment analysts, representing $200 billion worth of assets and on the platform with me was Pierre Rinfret, who has been one of Nixon's advisers and he had a little bit of a field day in which he recapitulated the forecasts of panels of economists like those of the National Industrial Conference Board and he showed that they were always too bearish in their forecasts, that they averaged 10, 15 billion too low in their forecasts. Now, they were just on the nose in 1967 but he said that is just because the economy happened to be weak in that year, and so you have, among economists, excessive bearishness. Now this is true in my judgment of the last Conference Board Forecast, too, and I puzzled about the matter and studied it and I'd like to report to you on it. The Wharton School has a econometric model under Lawrence Klein and it predicted, for the fourth quarter of last year, an $11 billion increase. This prediction was made in the middle of the quarter, in November and as you know, the increase was 17 or $18 billion. I thought only a machine could make a forecast as bad as that within one quarter, but I was wrong. When I looked at the Conference Board Forecast for the coming year, which is for a $915 billion GNP and which is a, more than 1% below my own forecast, I discovered that the fourth quarter numbers, on which the panel was operating, were by and large, already several billion dollars too low and actually, if I increase the yearly forecast, that's one way of making the correction, it's not the only way, to get them right in the fourth quarter, they are much more nearly on the beam, in my judgment, than appears from their very raw figures. Now there's a lesson in this. You should be as up-to-date as you can possibly be in making a longer run forecast, because that's the springboard for your forecast. Moreover, the committee member, Gainsbruch, who put together a summary of their forecasts, instead of just taking a mean of them, took all the reasonable things that he found out about them and he borrowed them from the forecast, just like taking a Model T part here and Chrysler part there and when we put 'em together, lo and behold, he had a wonderful sports car. He had a forecast which, if I correct for a proper fourth quarter figure, is very nearly on the beam with my own, well, that doesn't make it a wonderful forecast but it makes it more nearly on the beam with what we've been getting in recent times. So I conclude from this that you must be very careful in the way you score and use forecasts. Correct them so they are up-to-date and then you'll be surprised how much better the final figures will be. One last remark before I sign off, I think there's a reason why so many of these economists had numbers that were in the right direction, but were short of the full magnitude. It serves their purpose perfectly well to be qualitatively right, why stick your neck out and go all the way, even if your mean figure was higher and Professor Theil, whose name I mentioned earlier, has found this a very common aberration among forecasters and fortunately, it happens to be one we can correct for, rather mechanically, thank you.

- You have been listening to Dr. Paul Samuelson, professor of economics at MIT. If you have suggestions, questions, or comments, write Instructional Dynamics Incorporated, 166 East Superior Street, Chicago, 60611.