THE BEST OF BUSINESS ECONOMICS
HIGHLIGHTS FROM THE FIRST FIFTY YEARS

By
National Association for Business Economics

Edited by
Robert Thomas Crow
CONTENTS

Introduction xvii
Robert Thomas Crow

PART I 1965–1974 1

1. A New Look at Monetary and Fiscal Policy (1967) 3
   Paul A. Vöcker
   Although the recent past amply demonstrates the temptation for policy makers to
discount the complications that today's actions may create for tomorrow, it
would be a serious mistake to confine policy makers to a fixed monetary rule.
Part of our recent difficulties stemmed from underlying developments in financial
markets, such as the liberalization of institutional lending, that weakened
the "availability effects" of monetary policy. For the longer run, actions are
needed to make financial markets more evenly responsive to monetary policy.

2. The Role of Money in Economic Activity: Complicated or Simple? (1969) 9
   Edward M. Gramlich
   The FRB-MIT model focuses on monetary factors, with structural relation-
ships which highlight their transmission to the real economy. These are the cost
of capital channel (capital goods, housing, consumer durables and state and
local spending), the net worth of consumers and credit rationing. Money
proves to be important, but with lags long and variable. An extensive econo-
metric model is found more helpful than a single equation.

   Lawrence R. Klein
   The Wharton Model is extrapolated for 24 quarters with appropriate assump-
tions. The problems involved in specifying a fresh model for long range
forecasting are then outlined, including "endogenizing variables" such as gov-
ernment spending. Attention is drawn to the less precise performance in predic-
tions of the long run. Skepticism is expressed concerning deceptively
smooth and free hand extrapolations.

4. Presidential Address: The Challenge to Our System 31
   Alan Greenspan
   Concern is expressed about the extent of government intervention. Yet gov-
ernment has a role to play, e.g. in industrial pollution. But there are problems.
A law of fiscal constituencies is formulated: the growth rate of benefits to constituent groups tends to exceed the fiscal dividend. Grave questions remain about the fiscal outlook in coming years.

5. The Social Significance of Environmental Pollution (1970)
   Barry Commoner
   Environmental pollution is not an incidental by-product. Rather, it is an intrinsic feature of the very technology developed to enhance productivity. This technology is so imbedded in the agricultural and industrial production processes that the required change would involve serious economic dislocations. The author contends that the problem is so serious that these dislocations must be confronted.

6. The Productivity Slow-Down (1971)
   John W. Kendrick
   The slowdown in productivity since 1966 is due to: (1) the decline in R&D expenditures in relation to GNP; (2) the accelerated growth of the labor force, particularly in the youngest age groups; (3) the acceleration in price-inflation which has diverted resources to mitigating its unfavorable consequences; (4) social tendencies which have reduced the power of material goals and the work-ethic among a small but growing proportion of the population, particularly in the younger age-brackets.

7. Why Productivity Is Important (1973)
   Geoffrey H. Moore
   Productivity growth has played a key role in insuring higher real wages and in combating inflation over the last quarter of a century. These facts and others relating to productivity are documented as the relation of hourly compensation, productivity and unit labor costs is sketched, and the relation of the latter to total costs, prices and profits is outlined. Future real economic growth without inflation will depend on high rates of productivity growth.

PART II 1975–1984

8. Presidential Address: NABE and the Business Forecaster (1975)
   Robert G. Dederick
   Despite some success, economists, on the whole, have been sadly lacking in foresight, and have not provided their managements with advanced warning of the distressing situation into which the economy was drifting. Granted that the usual cyclical developments have been overwhelmed by explosive, structural shifts, it is doubtful that accuracy will be achieved upon a return to economic equilibrium. Accuracy was not present in earlier periods of equilibrium. Further, economists have tended to predict the unimportant and not the important. Explanations for the profession's forecasting failures are reviewed, and the point made that the relationships have been emphasized rather than the facts. A course of action for NABE is suggested.

9. Thoughts on Inflation: The Basic Forces (1975)
   Gottfried Haberler
   In a clear and concise fashion, the basic principles involved in inflation are reviewed. The author distinguishes three types of inflation: classical demand
Inflation, cost or wage push inflation, and shortage inflation stemming from special factors. Each type is analyzed and suggestions made as to how it can be treated. Special emphasis is placed on cost or wage push inflation and from what causes it arises. The spectrum of opinion on the part played by unionization in wage push inflation is reviewed. Finally, various anti-inflation policies are examined and some international aspects of inflation touched upon.

10. The Practical Use of Economic Analysis in Investment Management (1975) 85
   Edmund A. Mennis
   Economic analysis can be most effective if it is fully integrated into the investment decision process. Here, the investment decision process is described. Specific uses of economic analysis in the various parts of the process are detailed, examples are given, and certain caveats provided.

11. Presidential Address: On Human Welfare (1979) 95
    Albert G. Matamoros
    As important as it is continuously to assess our role as business economists, I think it is equally imperative that we step back, from time to time, and examine still broader issues. Today I want to raise some questions regarding the extent to which economic policies and the consequent actions of the agencies of government during the past 15 years have contributed to the human condition. It is not only appropriate, but I think mandatory, that, as social scientists, we be concerned for man's welfare and his destiny.

    Douglas L. Cocks
    The current concern over the lack of productivity growth in the US mandates certain actions by companies. One of these actions is the measurement of productivity for individual firms. This chapter presents some refinements in the measurement of Total Factor Productivity (TFP) at the firm level. In addition, alternative methodologies are investigated with the result that these alternatives yield consistent results. The chapter also demonstrates two applications of the TFP model to empirical investigations relevant to public policy issues: the impact of regulation on measured productivity and estimation of production functions for the firm. One interesting empirical result is that, given the necessary input data, the negative effects of regulation on productivity can be demonstrated through the TFP model.

13. The Adam Smith Address: Conservatives, Economists, and Neckties (1983) 121
    Herbert Stein
    One might expect Adam Smith to be the patron saint of economists of all ideologies. He was the father not only of a particular idea of how the economy works but also of the idea that there is an economic system. Moreover, some of his ideas about how the system works are incorporated in all kinds of economics, from extreme left to extreme right. Any economist teaching the history of economic thought would start with Adam Smith. But the wearing of Adam Smith neckties is not uniformly or randomly distributed among economists. Only economists who are, loosely, called conservatives wear it.

Marina v. N. Whitman

This chapter is based on a talk Dr. Whitman gave at Notre Dame University. In it, she shares some of her personal views on the various roles economists play in society, the need for greater interaction among academic, government, and business economists and the evolution of the role of corporate economists at General Motors Corporation.

15. The Adam Smith Address: Was Adam Smith a Monetarist or a Keynesian? (1984)

Charles P. Kindleberger

I give this talk the foregoing title (a) because it is the Adam Smith Lecture and (b) because I want to hold forth on Keynesianism and monetarism. It is evident, however, that to put the matter as a choice between a single pair of alternatives is fallacious. Adam Smith was and is under no compulsion to fall exclusively into one category or the other.

PART III 1985–1994


George J. Stigler

This chapter examines the effects of governmental policies upon the efficiency of the economy, including both traditional governmental areas (such as justice, defense, and environmental protection) and the vast and growing share of governmental programs aiming to redistribute income. A proposed principle of legitimacy states that every action set by a legislature represents a social judgment that society is better off for that action. Thus all governmental policies are by hypothesis utility-increasing for the nation. Any costs of (say) a redistribution of income are less than the benefits. National output as presently measured can and usually will fall when a new redistribution of income is instituted, because it is costly to redistribute income. Is this trend in governmental policy likely to be reversed, perhaps by a general movement toward deregulation? The author's answer to this question is calculated to restore the claim that economics is the dismal science.


James M. Buchanan

Economic choices are made by many buyers and sellers as they participate in many markets for many goods and services. “The Economy” is best described by the structure (the rules) within which these market choices take place. Efforts to reform the pattern of results observed in an economy should be directed exclusively at this structure: attempts to modify directly the outcomes or results of market process within structures are based on fundamental misunderstanding.


Paul Krugman

In the past decade, many economists are rethinking their historic belief in free trade. The theory of comparative advantage is being supplemented by a theory of increasing returns, i.e., the advantages of specialization per se. While the new
theory may strengthen the arguments for free trade, it also alters recommended
government trade policy. Subsidies may tilt competition in favor of a high
return domestic industry, giving it a head start and a persistent advantage. While
this new trade theory may not always be effective, it does change free trade
from a dogma to a reasonable rule of thumb in an imperfect world.

19. *The Adam Smith Address: The Suicidal Impulse of the Business*
    Community (1989) 181
    *Milton Friedman*
    Corporations often promote policies adverse to their own best interests. In the
    political arena, business has a short time horizon that differs from its approach
    in long-term corporate planning. Examples are given of business attitudes
    toward protectionist tariffs, tax and regulatory policy, fixed exchange rates, corpo­
    rate contributions, and budget and trade deficits. Corporations, acting in a
    climate that considers government action a cure for all problems, are contrib­
    uting to the destruction of a free market economy rather than shoring up its
    foundations.

    *Victor Zarnowitz*
    This chapter reviews the common core of the pervasive and persistent nonsea­
    sonal fluctuations that have characterized modern capitalist economies. But
    much diversity also exists, and the differences between cycles before and after
    World War II are discussed. Some reasons for these changes are offered. Finally,
    a brief comment considers the various theories advanced to explain “the”
    cycle, and the difficulty of so doing because cycles are not all alike.

    *J. Fred Weston*
    Empirical studies of international cost of capital comparisons have taken two
    related forms. One is to compare weighted average costs of capital (WACC) for
    samples across economies. Sample WACC comparisons may be subject to error
    because the cost of capital measures may not be applied to appropriate defini­
    tions of operating cash flows whose qualities, time-growth patterns, and risk
    may differ. Comparisons of riskless rates such as yields on government secu­
    rities ignore relevant risk differences. No financially derived competitive advan­
    tage is likely to exist with: (1) no net tax or subsidy differences, (2) capital
    market and economic integration.

22. *Health Insurance Derivatives: The Newest Application of Modern*
    Financial Risk Management (1993) 213
    *James A. Hayes, Joseph B. Cole, and David I. Meiselman*
    This chapter discusses the derivatives revolution in financial and other markets,
    emphasizing the gains in market efficiency and innovation by reducing transac­
    tion costs and promoting new product development. Health insurance futures
    and options, a natural extension of the derivatives revolution, will be trading at
    the Chicago Board of Trade in 1993. In addition to an overview of the struc­
    ture of the health insurance futures contract, an example is given of a long
    hedge by an insurance company to protect itself from unexpectedly higher
    claims payments.
*Murray Weidenbaum*

Two undesirable ways to achieve faster economic growth are to adopt an easy monetary policy or just cut tax rates. A better way is to deal with structural defects that depress productive capacity and productivity through structural reform. Budget cuts should aim to shift emphasis from programs that encourage consumption to those that encourage investment, review subsidy programs, avoid funding programs to offset problems caused by regulations, and privatize activities that belong in the private sector. Tax reform also should encourage saving, and regulatory costs should be reviewed in light of the benefits derived. Slow growth is not susceptible to a quick cure, but an extensive array of expenditure, tax, and regulatory reforms can shift the US economy to a higher growth path.

*Michael J. Boskin*

A review of episodes in economic and intellectual history indicates the superiority of a limited government market economy over the alternative models of economic organization. The siren calls of pundits, politicians, and even some economists in favor of Communist central planning during the Great Depression, market socialism after World War II, and, more recently, massive welfare states and/or extensive government micromanagement of markets each ran afoul of their own problems and comparisons to the limited government (based on sound criteria) capitalist model. The limited government capitalist model, once again under attack from those who would greatly expand the role of government, needs its defenders, as the alternative models have proven historically, intellectually, and practically bankrupt.

*Henry Kaufman*

Recent distress in world financial markets has underlined the need for supervising and regulating financial institutions and markets on a global basis. A new institution, in addition to the International Monetary Fund (IMF) and the World Bank, is required to set forth a code of conduct to encourage reasonable financial behavior and to supervise risk-taking. It also should be empowered by member governments to harmonize minimum capital requirements, to establish uniform trading, reporting, and disclosure standards, and to monitor the performance of institutions and markets under its purview. The IMF should be able to demand policy changes in anticipation of problems. Securitization and the development of financial derivatives have liberalized granting of credit, requiring steeper interest rates to end a period of excessive monetary expansion. Monetary policy also should be concerned with asset inflation as well as price inflation.

Alan S. Blinder

Over the years, economists have spent much effort to modify the capitalist, perfect-competition, profit-maximizing model of classical microeconomics to fit reality. Thus, it is ironic that in recent times reality has been approaching the classical model. This is due only in part to the persuasive talents of economists, and not all of this change is necessarily an improvement. Among the factors contributing to the reversion to the classical model are the failure of socialism, alignment of managerial and shareholder interests, focus on shareholder value, decline of labor union power, changes in financial markets, global competition, and changes in regulatory practices.


Henry Kaufman

The breadth and depth of Adam Smith’s thought over 200 years ago still provide powerful lessons today. Were he present, he would applaud much of what has transpired in the organization of economic life, particularly in the US economy and its thrust toward individual achievement and relatively free markets for goods and services, capital, and labor. However, he would also be deeply troubled by recent trends toward consolidation, particularly in the financial sector, and the emergence of “too-big-to-fail” as an argument for government to weaken the discipline of markets.


Kevin J. Stiroh

Aggregate, industry, and firm level studies all point to a strong connection between information technology (IT) and the US productivity revival in the late 1990s. At the aggregate level, growth accounting studies show a large and growing contribution to productivity growth from both the production and the use of IT. At the industry level, industries that produce or use IT most intensively have shown the largest increases in productivity growth after 1995. At the firm level, IT-intensive firms show better performance than their peers, and several specific case studies show how IT improves real business practices. This accumulation of evidence from a variety of studies suggests a real productivity impact from IT.


Harvey Rosenblum

Economic theory—much less modeling based on historical data—has a difficult time keeping up with structural change in the contemporary economy. Anecdotal evidence and a feel for the economy based on experience are likely to be as important as theory-based modeling in making real-time policy decisions on the control of inflation and the stability of the economy. Many of the phenomena to be understood are microeconomic in nature. While much has been learned about effective stabilization policy over the past forty years, economists still have a long way to go before inflation can be understood and managed.

Long-term global economic health requires that external imbalances and the internal imbalances that support them be corrected by both the United States and its trading partners. The current path of external imbalances appears to be unsustainable, but relying on exchange rate adjustments is unlikely to suffice as long as there is a co-dependency of structural characteristics and policy choices between the United States and its trading partners. There is a real possibility that the entanglements created by this co-dependency cannot be undone by anything short of a global economic crisis.

PART V 2005–2015


Over the past 20 years, the use of monetary policy rules has become pervasive in analyzing and prescribing monetary policy. This chapter traces the development of such rules and their use in the analysis, prediction, and stabilization of national economies. In particular, rules provide insight into eras in which monetary policy was not effective as well as when it was, such as the persistence of the ongoing "Great Moderation." The chapter stresses "the scientific" contributions of rules, including their insight into fluctuations of housing construction and exchange rates, as well as into the term structure of interest rates.

32. The Adam Smith Address: Adam Smith and the Political Economy of a Modern Financial Crisis (2008) Michael Mussa

Financial crises have occurred periodically for hundreds of years, and Adam Smith had important insights into their causes. Although by no means all that we know about such crises has been derived from Smith, it is interesting and important to reflect on what he did know and how ignoring his warnings about the creation of excess liquidity has contributed to the current crisis. In addition to the complexity of contemporary finance and the role of central banks and other regulatory institutions, a major difference between Smith's day and ours is the emergence of "moral hazard" as an important policy issue and its corollary, "immoral results." It is important to realize that the risks of financial crisis, moral hazard, and immoral results cannot be avoided by financial and accounting gimmicks, and that there is no substitute for adequate capital in the creation of liquidity.


Lowering of underwriting standards may have contributed much to the unprecedented recent rise and subsequent fall of mortgage volumes and house prices. Conventional data do not satisfactorily measure aggregate underwriting standards over the past decade: the easing and then tightening of underwriting, inside and especially outside of banks, was likely much more extensive than
they indicate. Given mortgage market developments since the mid-1990s, the
method of principal components produces a superior indicator of mortgage
underwriting standards. We show that the resulting indicator better fits the var­
iation over time in the laxity and tightness of underwriting. Based on a vector
auto-regression, we then show how conditions affected underwriting stan­
dards. The results also show that our new indicator of underwriting helps
account for the behavior of mortgage volumes, house prices, and gross domes­
tic product during the recent boom in mortgage and housing markets.

34. The Impact of the Housing Market Boom and Bust on
Consumption Spending (2010) 377
Jeremy A. Leonard
While econometric evidence for the United States has consistently shown that
increases in real estate wealth induce additional consumption, it does not
directly speak to the effect of a substantial decrease in real estate wealth. This
chapter examines the real estate wealth-consumption relationship over the past
half century with a particular focus on the sharp decline in 2006-2008, and
finds that the wealth effect in the recent down market is significantly larger
than in an up market. Additionally, wealth changes seem only to affect con­
sumption of services and nondurable goods; there is virtually no impact on
durable goods consumption.

35. The Adam Smith Address: Macropredential Supervision and Monetary
Policy in the Post-Crisis World (2010) 393
Janet L. Yellen
Until two years ago, it was believed that the financial system as a whole was
self-correcting and that modern tools of stabilization policy—monetary policy
in particular—were sufficient to prevent severe economic contractions. We
now know that we need a robust system of regulation and supervision that will
recognize and prevent financial excesses before they lead to crisis, while at the
same time maintaining an environment conducive to financial innovation. This
address traces the causes of the crisis and the role of the Dodd-Frank Act in
providing a framework for preventing recurrence. It then describes what must
be done to identify emerging systemic financial risk, the tools and implemen­
tation of macropredential financial supervision that must be developed, and
the role of coordination between monetary policy and macropredential super­
vision. Prevention of crises will not be easy—particularly because it will be
necessary to walk a tightrope between prevention of catastrophe and keeping
too tight a hold on the financial system.

36. The Adam Smith Address: Nightmare on Kaiserstrasse (2011) 407
Kenneth Rogoff
The overhang of debt (private and surging public) is perhaps the principal reason
why recessions following financial crises are so deep and lasting. Frequently, a wave
of international financial and banking crises is followed by a wave of sovereign
defaults. This is the case of the Eurozone crisis today. How might a sovereign debt
default of, say, Greece affect the Eurozone? The nightmare scenario is a complete
unraveling of the euro. The euro can still be saved, but perhaps only with the
weaker countries undergoing major restructuring of their sovereign debt.
Roger W. Ferguson, Jr.
The US economy, while recovering, is still feeling lingering effects of the 2008 financial crisis and the recession that followed. Although government has acted to prevent a future recurrence, much needs to be done—particularly in corporate governance of financial firms. Currently, there is a pervasive lack of trust in the financial industry, which will be difficult to undo. Nonetheless, finance is so important that it is critical that trust be restored. This is particularly true in an era in which planning for retirement is inadequate, and financial literacy is increasingly important. This implies a critical role for a financial services industry whose guidance can be trusted. This trust must be built through appropriate corporate governance on the part of all stakeholders, and specific recommendations are advanced for bringing this about.

Lawrence H. Summers
The nature of macroeconomics has changed dramatically in the last seven years. Now, instead of being concerned with minor adjustments to stabilize about a given trend, concern is focused on avoiding secular stagnation. Much of this concern arises from the long-run effects of short-run developments and the inability of monetary policy to accomplish much more when interest rates have already reached their lower bound. This address analyzes contemporary macroeconomic problems and proposes solutions to put the US economy back on a path toward healthy growth.

PART VI Feature Articles 437

David A. Petina, Michael Murphy, and Andrew C. Gross
The US electrical grid must be upgraded, and there is a strong debate about the characteristics of the next-generation electrical network. However, slow growth of electricity usage, among other factors, means that the demand for transmission and distribution (T&D) equipment is growing slowly also. Within the T&D equipment sector, switchgear and transformers are still the dominant segments, but sales of meters are growing rapidly in response to increased demands for security, safety, and connectivity. Six firms hold about 40 percent of the T&D equipment market share, selling to electric utilities, nonutility industrial firms, commercial firms, and residential customers. Foreign trade is also important in this industry, with the United States running a substantial trade deficit.

40. Focus on Statistics: Initial Results of the 2012 Economic Census (2014) 455
Robert P Parker
The initial results of the 2012 Economic Census are being released and will continue to be released until mid-2016. It provides detailed industry and geographic data used by businesses, researchers, and government policy makers. It
provides the detailed data used to benchmark the Index of Industrial Production and the Producer Price Index, and to prepare input-output accounts and quarterly GDP. The Census Bureau uses the data to benchmark most of the Census Bureau's annual, quarterly, and monthly economic surveys and this benchmarking maintains the reliability of these sample surveys. The 2012 Economic Census is essentially the same as 2007 census.


*Thomas Kevin Swift*

This chapter examines the role of the economics team at the American Chemistry Council, a major trade association representing the leading companies in the business of chemistry. The history of the team, its organization, its role in providing good statistics, monitoring and forecasting business conditions, conducting policy analysis, and thoughts on managing professionals are presented.