

Prize Fight

It's been controversial from the start: Alfred Nobel didn't envision an economics prize in his will. And some giants in the field, like John Maynard Keynes, died before the prize was established.

By RHEA WESSEL

NOBEL LAUREATES in economics meeting this week at Lindau will have plenty of stories to share about belonging to their all-exclusive group. Membership comes with a fair amount of honor, responsibility and stigma.

Stigma? Well, yes. Some holders of the Nobel Prize for the natural sciences argue that economics is not a hard science and is therefore not worthy of the Nobel name. At the awards ceremony in 1969—the first year the economics prize was handed out—one physicist said to Murray Gell-Mann, who won the physics prize that year: “You mean they sat on the platform with you?”

Although awarded with the same purse and the same rigorous selection process, the Nobel Prize in economics hasn't been able to shake off completely its second-tier image. The prize was not envisioned by Alfred Nobel in his will. It was established to mark the 300th anniversary of Sweden's central bank. It bears a different name—The Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel—and winners' names are engraved on the outer rim of medals instead of on the surface.

Hayek and Myrdal

One late economics laureate, Gunnar Myrdal, was apparently insulted to share the prize in 1974 with Friedrich A. von Hayek and accused the Royal Swedish Academy of Sciences, which awards the prize, of making a political statement with the joint award. Mr. Myrdal thought the academy was trying to temper his 20th-century liberalism with the classical liberalism of Mr. Hayek, according to Abu N.M. Wahid, a professor at Tennessee State University who has studied the lives and contributions of the laureates of the 20th century.

Mr. Hayek also showed his share of disregard for the honor, saying during the awards banquet in 1974 that he would have “decidedly advised” against a prize in economics, had he been asked. (See accompanying story for the text of Mr. Hayek's banquet speech.)

Others say that with the average age of prize winners around 67, accolades such as the American Economic Association's John Bates Clark Medal, awarded every second year to an economist under 40, goes much further in promoting the science.

Ideas Matter

“For the most part, the work of winners such as Paul Samuelson, Robert Solow and Kenneth Arrow is typically well recognized before they get the Nobel Prize,” says Joseph E. Stiglitz, who shared the prize in 2001 and considers economics a behavioral science.

“It is influential and used in graduate schools around the world,” Mr. Stiglitz continues. “Within the economics profession itself, it's the work that has the influence and not the prize—it's the ideas that have the influence. In the broader community, it does bring attention to certain ideas that otherwise might not be as well understood or even understood.”

In 2001, as preparations were made

Ms. Wessel is a writer in Frankfurt.

to mark the 100th anniversary of the original prize, some Nobel family members placed an advertisement in the Svenska Dagbladet, an influential Swedish daily, to urge that the Nobel name be dropped from the economics prize.

“Had Alfred Nobel really wanted such a prize, he would have named it himself in his will,” said four great-grandchildren of Alfred Nobel's brother Ludvig. “He did not, and therefore the ... prize should not be considered a Nobel Prize.” Moreover, they quoted a letter he wrote, in which he said, “There is not a single reason why I, who have no business schooling and heartily hate it, should be tormented by all these matters which I know as much about as the man in the moon.”

Obviously, their efforts didn't pan out. The economics prize remains the top



Friedrich A. von Hayek, a leading thinker in the Austrian free-market school of economics, was co-winner of the 1974 economics prize. He said in his banquet speech that there shouldn't even be a prize.

honor that can be bestowed on an economist, despite the lingering controversy.

The Jinx

For some Nobel laureates, the prize seems to be a jinx.

There's the story about Robert Lucas Jr. He won the prize in 1995 only to lose half the prize money to his ex-wife in a divorce settlement. Years earlier, she had anticipated that he would win the Nobel, and she claimed her share of the money in advance.

Fellow laureate Lawrence R. Klein came close to losing part of his prize money to the U.S. tax man. He won shortly before the Nobel Prize became taxable in the U.S. At a banquet in 1980, he shared the platform with the head coach of the Philadelphia Phillies, who won the World Series the same year. Mr. Klein joked that although both winners got a bonus of sorts, he at least didn't have to pay taxes on his.

In 1997, Robert C. Merton and Myron S. Scholes shared the prize for their work on derivatives, ideas they applied to the hedge fund they helped establish. A year later, Long-Term Capital Management collapsed and nearly dragged down the entire global system with it.

One of the saddest stories is the case of William Vickrey. Mr. Vickrey, who was recognized for his theories about asymmetric information, was found slumped behind the steering wheel of his car only three days after winning in 1996. He died as he was driving alone

from New York to Boston for an academic conference.

In one of his last interviews, Mr. Vickrey said, “Forty-five years is a long time to wait for your ideas to take hold,” adding, “I want to make the most of the good bully pulpit. And I have a couple of books to write.”

Give Keynes a Prize

Nobel prizes are not awarded posthumously, of course, and some say that rule has denied many a deserving economist the prize.

John Maynard Keynes, Alfred Marshall and Karl Marx are some of the influential economists who might have been honored if not for their deaths, according to Mr. Wahid, the Tennessee State professor. Indeed, many of the Nobel laureates responding to The Wall Street Journal's survey on page R4 say a towering figure like Mr. Keynes would deserve to win the prize.

But even if the award were made posthumously, politics could get in the way, some believe. According to Mr. Wahid, the “free enterprise” people at the Royal Swedish Academy of Sciences have the upper hand. Or, one could say they steer the invisible hand that selects the winners in a process shrouded in secrecy.

Joan Robinson, a Cambridge economist who died in 1983, is a case in point. Many economists believe that the academy overlooked her, not because she was a woman, but because of her admiration for Mao Zedong's China and Kim Il Sung's North Korea. A woman has not yet been awarded the prize, and Mr. Wahid doesn't expect one to win soon.

“The whole economics community recognizes her contribution,” says Mr. Wahid.

Some Nobel laureates—including conservative Milton Friedman—say Ms. Robinson deserved to win the prize. She contributed to the development of Keynesian economic theory, explained economic theory in books and articles for nonspecialists, and was one of the first economists to take Karl Marx seriously as an economist rather than as just a political thinker.

When Robert A. Mundell won the Nobel Prize in 1999, some analysts thought

the Swedish academy was embracing the euro, given his analyses that supported the idea of the single European currency. Whatever the case, Mr. Mundell put his money where his mouth was.

Mundell's Money

“It is true that I accepted Nobel money in euros and in fact lost money when the euro was going down, over \$50,000,” (or the current equivalent of €41,000), Mr. Mundell says in an e-mail from China, where he was visiting this week. “I would have lost more, but I sold the euro for dollars well before it hit bottom, and then bought euros again on the upswing. On balance I made up some but not all of my losses on the upswing.”

One form of politics that seeps into the Nobel process is what Mr. Wahid terms “shameless self-promotion.” The shortlist of nominees is supposed to remain secret, along with all the supporting documents and votes, he says. When it leaks, some nominees have been known to try to influence the committee through their governments or friends.

In his study of the laureates of the 20th century, Mr. Wahid made a variety of demographic and anecdotal observations. More than three-fourths of the winners in that period were American, and not a single Chinese, Japanese or Arab economist has been honored.

Only two non-Caucasians have won—Sir Arthur Lewis from Saint Lucia and Amartya Sen, an Indian-born British citizen. According to Mr. Wahid, Mr. Sen had waited so long to be acknowledged that his mother back in India wouldn't believe that he had won the prize until she saw it on television.

Sartre Says 'Non'

None of the winners of the economics prize have declined to accept it. By contrast, Le Duc Tho, the Vietnamese Communist leader, refused the Nobel Peace Prize in 1973, the year U.S. Secretary of State Henry Kissinger also received the award. Le Duc Tho said peace had not been established in Vietnam. French writer Jean-Paul Sartre declined the Nobel Prize in Literature in 1964, saying the prize could interfere with his responsibility to his readers.

Once an economist has won the award, most are besieged with requests

for lectures and papers.

Mr. Klein, who is considered a legend in economic modeling, said laureates are under intense pressure to travel the speaker circuits, sometimes booking 15,000 to 25,000 miles (24,000 to 42,000 kilometers) a month. He chooses his engagements based on the amount of time he has available, his interest in

“The present administration has used economic problems that were brought about by the military...to introduce strong tax reform for their pet proposals...that are geared toward increasing economic inequality,” he says. “They should not have used the excuse of needing to support the wartime economy to change the structure of the tax system. They should have acted right away on a distribution at the low end.”

Don't Cancel the Prize

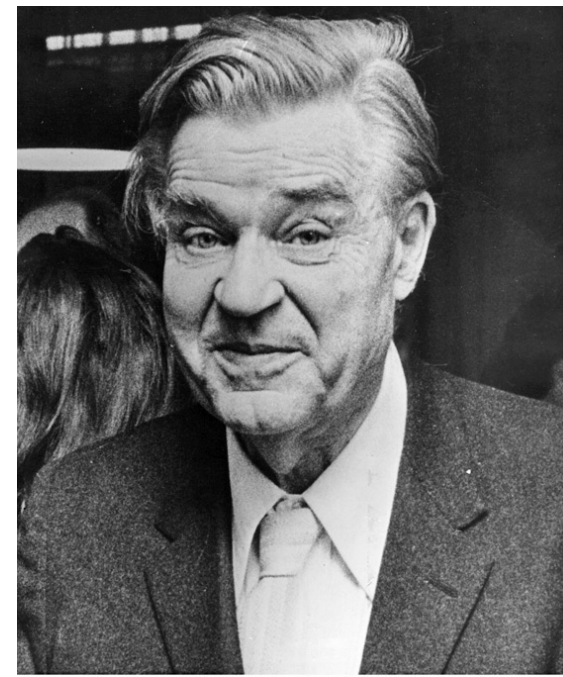
Though the prize has a few outspoken critics, it's safe to say that a majority of laureates are in favor of it.

“I think the question of whether there should be a Nobel Prize in economics is exactly the same as a question of whether there should be a Nobel Prize in physics, medicine or chemistry,” says Robert M. Solow, winner of the economics prize in 1987.

“The prize has some purpose in publicizing good science of one kind or another, and I think that's generally a good thing,” Mr. Solow continues. “On the other hand, good physicists, good chemists, good economists and good biologists will do their work whether or not there is a Nobel Prize. I think that it doesn't mean very much for the progress of science, but I do expect that having the Nobel Prize does help in improving the public knowledge of science, including economics.”

Vernon L. Smith, co-winner of the 2002 economics prize, says, “I have never felt that it was a significant plus for the profession... I understand that there has been some support in Sweden for broadening the award and making it more interdisciplinary with less emphasis on narrow professional economic themes. Some of the awards have reflected this sentiment—[Friedrich A. von] Hayek, [Douglass C.] North, [Robert W.] Fogel and [Herbert A.] Simon are prominent examples.”

Another laureate, George A. Akerlof, who shared the prize in 2001 with Joseph E. Stiglitz and A. Michael Spence, adds, “I think there is a great deal of good work being done in economics... And furthermore, the best research is yet to come. I can say that the prize is a very good thing for economic policy and for the economics profession. I'd be very unhappy if it were cancelled.” ■



Swedish economist Gunnar Myrdal was co-winner of the 1974 economics prize. He accused the Swedish Academy of making a political statement by having him share the award with Friedrich A. von Hayek.

the subject and the worthiness of the cause.

“I'm called upon to be somewhere almost every month and to talk about something I don't specialize in,” says Mr. Klein, who turns 84 this month. “There's an enormous pressure to speak out on any subject and any topic of economics.”

Mr. Klein, who prepares a weekly forecast for the U.S. economy, thought it worth his time to comment in 2003 on the Bush administration's plans for a dividend tax cut.

He was one of 10 Nobel laureates to sign a statement that sharply criticized the proposal. It was the first time that so many laureates had joined forces to condemn an idea, according to the Economic Policy Institute, a left-leaning Washington think tank that drafted and circulated the statement.

One year later, Mr. Klein said his criticism has proved correct.

Top Guns

Nobel laureates in economics since the awarding of the first prize in 1969

YEAR	PRIZE WINNER	AFFILIATION	REASON FOR PRIZE
2003	Robert F. Engle III	New York University	Use of statistical methods for economic time series
	Clive W.J. Granger	University of California San Diego	Use of statistical methods for economic time series
2002	Daniel Kahneman	Princeton University	Integrating insights from psychological research into economic science
	Vernon L. Smith	George Mason University	Establishing laboratory experiments as tool in empirical economic analysis
2001	George A. Akerlof	University of California Berkeley	How control of information affects markets
	A. Michael Spece	Stanford University	How control of information affects markets
	Joseph E. Stiglitz	Columbia University	How control of information affects markets
2000	James J. Heckman	University of Chicago	Development of theory and methods for analyzing selective samples
	Daniel L. McFadden	University of California Berkeley	Development of theory and methods for analyzing individual choices
1999	Robert A. Mundell	Columbia University	Exchange-rate analysis that helped lay the groundwork for Europe's common currency
1998	Amartya Sen	Trinity College Cambridge	Economic mechanisms underlying famines and poverty
1997	Robert C. Merton	Harvard University	New method to determine the value of derivatives
	Myron S. Scholes	Long-Term Capital Management	New method to determine the value of derivatives
1996	James A. Mirrlees	University of Cambridge	Economic theory of incentives under asymmetric information
	William Vickrey	Columbia University	Economic theory of incentives under asymmetric information
1995	Robert E. Lucas Jr.	University of Chicago	Developing and applying the hypothesis of rational expectations
1994	John C. Harsanyi	University of California Berkeley	Contributions to game theory
	John F. Nash Jr.	Princeton University	Contributions to game theory
	Reinhard Selten	University of Bonn	Contributions to game theory
1993	Robert W. Fogel	University of Chicago	Applying economic theory and quantitative methods to explain economic and institutional changes
	Douglass C. North	Washington University	Applying economic theory and quantitative methods to explain economic and institutional changes
1992	Gary S. Becker	University of Chicago	Extending microeconomic theory to a wide range of human behavior
1991	Ronald H. Coase	University of Chicago	Discovering and clarifying significance of transaction costs and property rights for the functioning of economy
1990	Harry M. Markowitz	City University of New York	Pioneering work in the theory of financial economics
	Merton H. Miller	University of Chicago	Pioneering work in the theory of financial economics
	William F. Sharpe	Stanford University	Pioneering work in the theory of financial economics
1989	Trygve Haavelmo	University of Oslo	Clarification of the probability theory foundation of econometrics

YEAR	PRIZE WINNER	AFFILIATION	REASON FOR PRIZE
1988	Maurice Allais	École Nationale Supérieure des Mines de Paris	Contributions to the theory of markets and the efficient use of resources
1987	Robert M. Solow	Massachusetts Institute of Technology	Contributions to the theory of economic growth
1986	James M. Buchanan Jr.	Center for Study of Public Choice	Research in the theory of economic and political decision making
1985	Franco Modigliani	Massachusetts Institute of Technology	Analyses of saving and of financial markets
1984	Richard Stone	University of Cambridge	Contributions to the development of systems of national accounts
1983	Gerard Debreu	University of California Berkeley	Reformulation of the theory of general equilibrium
1982	George J. Stigler	University of Chicago	Studies of industrial structures and the causes and effects of regulation
1981	James Tobin	Yale University	Analysis of financial markets and their relation to expenditure, production, employment and prices
1980	Lawrence R. Klein	University of Pennsylvania	Creation of econometric models
1979	Sir Arthur Lewis	Princeton University	Economic-development research
	Theodore W. Schultz	University of Chicago	Economic-development research
1978	Herbert A. Simon	Carnegie Mellon University	Decision-making process within economic organizations
1977	James E. Meade	University of Cambridge	Contributions to theory of international trade and capital movements
	Bertil Ohlin	Stockholm School of Economics	Contributions to theory of international trade and capital movements
1976	Milton Friedman	University of Chicago	Achievements in consumption analysis, monetary history and theory
1975	Leonid Vitalyevich Kantorovich	Academy of Sciences Moscow	Contributions to the theory of optimum allocation of resources
	Tjalling C. Koopmans	Yale University	Contributions to the theory of optimum allocation of resources
1974	Friedrich A. von Hayek	London School of Economics	Pioneering work in theory of money and economic fluctuations
	Gunnar Myrdal	Stockholm University	Pioneering work in theory of money and economic fluctuations
1973	Wassily Leontief	Harvard University	Development of input-output method
1972	Kenneth J. Arrow	Harvard University	Contributions in general economic equilibrium theory and welfare theory
	John R. Hicks	All Souls College Oxford	Contributions in general economic equilibrium theory and welfare theory
1971	Simon Kuznets	Harvard University	Empirically founded interpretation of economic growth
1970	Paul A. Samuelson	Massachusetts Institute of Technology	Developed static and dynamic economic theory, contributed to raising level of economic analysis
1969	Ragnar Frisch	University of Oslo	Developed and applied dynamic models for the analysis of economic processes
	Jan Tinbergen	Netherlands School of Economics	Developed and applied dynamic models for the analysis of economic processes

Source: Nobel e-Museum (www.nobel.se)

Why Hayek Would 'Advise Against' A Nobel Prize in Economics

Friedrich A. von Hayek had some startling words when he addressed the Nobel banquet on Dec. 10, 1974:

Your Majesty, Your Royal Highnesses, Ladies and Gentlemen,

Now that the Nobel Memorial Prize for economic science has been created, one can only be profoundly grateful for having been selected as one of its joint recipients, and the economists certainly have every reason for being grateful to the Swedish Riksbank for regarding their subject as worthy of this high honor.

Yet I must confess that if I had been consulted whether to establish a Nobel Prize in economics, I should have decidedly advised against it.

One reason was that I feared that such a prize, as I believe is true of the activities of some of the great scientific foundations, would tend to accentuate the swings of scientific fashion.

This apprehension the selection committee has brilliantly refuted by awarding the prize to one whose views are as unfashionable as mine are.

I do not yet feel equally reassured concerning my second cause of apprehension.

It is that the Nobel Prize confers on an individual an authority which in economics no man ought to possess.

This does not matter in the natural sciences. Here the influence exercised by an individual is chiefly an influ-

ence on his fellow experts; and they will soon cut him down to size if he exceeds his competence.

But the influence of the economist that mainly matters is an influence over laymen: politicians, journalists, civil servants and the public generally.

There is no reason why a man who has made a distinctive contribution to economic science should be omniscient on all problems of society—as the press tends to treat him till in the end he may himself be persuaded to believe.

One is even made to feel it a public duty to pronounce on problems to which one may not have devoted special attention.

I am not sure that it is desirable to strengthen the influence of a few individual economists by such a ceremonial and eye-catching recognition of achievements, perhaps of the distant past.

I am therefore almost inclined to suggest that you require from your laureates an oath of humility, a sort of Hippocratic oath, never to exceed in public pronouncements the limits of their competence.

Or you ought at least, on conferring the prize, remind the recipient of the sage counsel of one of the great men in our subject, Alfred Marshall, who wrote: “Students of social science must fear popular approval: Evil is with them when all men speak well of them.”

(Mr. Hayek's speech is reprinted on Nobel e-Museum, www.nobel.se) ■

On the One Hand...

Nobel laureates debate the merits of Bush and Kerry economic policies

By RHEA WESSEL

TAKE YOUR PICK: The U.S. economy is in great shape and could use even more tax cuts. Or the tax cuts are creating giant deficits and are undermining American economic health.

No, this is not the latest spin from the Bush and Kerry campaigns. These strikingly different conclusions come from a rarefied group: some Nobel laureates in economics. Some say President Bush's tax cuts will create more savings and investment and power economic growth. Others, though, say large deficits are putting the economy at risk and tax cuts have had little or no effect as a stimulus.

In separate interviews, Milton Friedman and Vernon L. Smith played down the risks of the deficit and welcomed even more tax cuts. The deficit "is not a problem if the government holds down spending," Mr. Friedman says. "The economy will grow and develop, and the deficit will decline."

However, George A. Akerlof, Lawrence R. Klein, Robert M. Solow and Joseph E. Stiglitz criticized the Bush administration's economic policies. Indeed, they are among 10 Nobel laureates in economics who recently endorsed Sen. John Kerry for president. With the change from a budget surplus under former President Clinton to record budget deficits, Mr. Bush's economic policy represents "a major risk to the American economy," Mr. Stiglitz says.

Weak Recovery in Jobs

The state of the U.S. economy will be a key factor in the remaining two months of the presidential election campaign. The government reported last month that employers added just 32,000 jobs in July—the lowest total this year and a sharp slowdown from the spring. Moreover, the job worries sent consumer confidence tumbling in August. Consumer pessimism has been fed by high gasoline prices this summer and a rise in interest rates. Even so, few analysts believe the U.S. is headed back into recession because some other economic indicators have been positive, such as a rebound in retail sales. The unemployment rate is 5.5%, the lowest level in three years.

"The economy is doing very, very well," contends Mr. Friedman, the 1976 Nobel laureate in economics. "What people are complaining about is that the recession wasn't deeper. Had the recession been deeper, the current recovery would be stronger. When you have a mild recession, you tend to have a mild expansion. When you have a severe recession, you tend to have a vigorous expansion."

In late July, the White House projected a record budget deficit of \$445 billion (\$365 billion) for fiscal 2004, which ends Sept. 30. That's down from its previous estimate of \$521 billion. Democrats say the budget shortfall shows deteriorating U.S. fiscal health.

'Deficits Do Matter'

"Most economists think that deficits do matter when they get very large," says Mr. Stiglitz, a 2001 Nobel laureate and a former chairman of President Clinton's Council of Economic Advisers. "There's a debate about how aggressive one should pursue deficit reduction. This kind of deficit is so large that this debate is not necessary."

Mr. Klein contends the dividend tax cut significantly increased the budget deficit. Under Mr. Bush's tax plan, the tax rate for most individual investors on corporate dividends was cut to 15%. Previously, investors had paid tax on dividends at their personal-income-tax rate, which could be as high as 39%.

"I think the tax policy in general is not well conceived," says Mr. Klein, the 1980 Nobel laureate. "It should have been for people who would have been highly likely to spend a good share of it, and it was not engineered that way." What the U.S. needs, he says, "is a tax concession for the relatively lower and middle income groups who will be likely to spend it."

For his part, Mr. Friedman says "the top 1% of taxpayers pay a disproportionate amount of taxes. You can't give tax relief to those who don't pay a lot of tax." Wealthy taxpayers, he says, "end up either investing it or giving it away."

President Bush wants Congress to make permanent the tax cuts enacted during his administration, while Sen. Kerry wants to repeal the tax cuts for high-income Americans. He would raise the top marginal income tax rate of 35% back up to 39.6%, increase the 15% top rate on dividends to as high as 39.6% and raise the top rate on capital gains on securities held more than one year to as much as 20% from 15%.

Mr. Smith, a 2002 Nobel laureate, calls Mr. Kerry's idea of repealing tax cuts for the wealthiest taxpayers "bad policy"

that creates a risk of reducing savings and investment. "Some 90% of taxes are paid by the upper 50% income-tax bracket," he says. "No one gets anything if there isn't anything. Productivity, innovation and wealth creation is the only source of poverty reduction and human betterment."

The anti-Bush laureates counter that the administration's tax cuts have been a failure on two counts: Not only have they failed to give a short-term stimulus to the economy, they argue, but the tax cuts have failed in moral terms by widening the income gap.

"It seems to be almost a paradox that we're now taxing income from capital—from unearned sources—at a much lower rate than income from earned sources," says Mr. Akerlof, a 2001 Nobel laureate whose wife is Janet L. Yellen, a former chair of President Clinton's Council of Economic Advisers and the current president of the Federal Reserve Bank of San Francisco. "I would have thought that one of the first requisites of fair taxation is that unearned income on capital should be taxed at least the same rate as the income earned by labor."

Mr. Akerlof also argues that the Bush stimulus package puts the economy at risk. "If there are large deficits down the road, they can raise long-term interest rates," causing the opposite of a stimulus, he says.

Mr. Friedman, on the other hand, welcomes permanent tax cuts and says higher deficits will eventually restrain government spending. And Mr. Smith says the dividend tax cut "did not go far enough. The double taxation should end, and its end is long overdue. To me it should not even be a political and partisan issue."

Mr. Solow says that despite the slower-than-average upswing after the end of a recession, he doesn't expect growth to halt. "I think that politically we will go into the election with an economy that is not a disaster at all but an economy that is not a great success," he says. "We'll have the usual spectacle of the incumbents picking out every good thing that has happened and the Democrats picking out every bad thing that has happened." ■

Journal Link: WSJ.com subscribers can see the full text of the interviews in the Online Journal, at WSJ.com/JournalLinks.

Lawrence R. Klein

Nobel Laureate, 1980

What has been the impact of the Bush administration's cut in the dividend tax?

The tax cut increased the deficit significantly without being a big support for capital formation.

The biggest single event that happened is the announcement by Microsoft to distribute something like \$30 billion. Some of this decision was motivated by tax considerations. Microsoft will get a big tax break. But you have to see what people do with [the distribution] to see if it is something that will increase consumer spending.

Microsoft is not investing heavily in the sense that they're accumulating reserves that they can distribute. So that is in some sense a little bit tied up with the low tax on dividends, but it's not helping the economy.

What about the Kerry proposals?

I don't know the Kerry proposals in detail yet, but in general I would say to do away with the tax concession at the high end and use those funds for tax concessions at the low end.

What policies would you implement to stimulate the economy?

Well, I've been involved in a major study on offshoring. The typical example is the Indian software industry in Bangalore and Hyderabad. People are opposed to it because it seems to be taking white-collar jobs from America and moving them to low-wage countries. India is not the only country, but it's the biggest single country...I would argue that it's not a bad thing to happen. There may be some loss of jobs in the short term, but in the longer run, we get those jobs back because we get more exports in other areas.

In our studies of offshoring, I've found that for a year or two, we might lose some jobs but we could try to compensate for that. In the longer run, we would gain by lower costs.

The appropriate policy for offshoring is to have training classes for people who are downsized and we should use higher technology. We should take a longer view of the effects of offshoring. Offshoring is making our economy more efficient.

What else are you working on?

I have been working for some time on estimations of China's growth rate. This summer I am supervising visiting Chinese research scholars, and we're investigating whether the Chinese price index is overstated because they don't take account of quality improvements since the 1978 reforms.

This is a rather important point. The U.S. appointed a committee to investigate our price index, and they lowered the rate of inflation. They said it was overstated so much that they raised the growth rate. They adjusted our consumer price index for quality improvements and to reflect cheaper sources for buying goods.

In China, I claim that quality improvements on the market basket of goods have been much, much larger than in the U.S. If you make that adjustment, I think the Chinese inflation rate will be 1 or 2 percent lower and the growth rate, which is high, will be even higher.

Describe what you mean by the quality of the market basket of goods.

If you consider the average car available in 1979 and the fleet of taxis and cars available now, there's an enormous quality difference. If you consider the clothing people were wearing in 1979, especially women wearing the baggy blue suits...

You mean the Mao suits?

Yes, exactly, now everything is colorful. I say all that is quality improvement. Also in restaurants, housing, etc. The whole quality of life is better.

Vernon L. Smith

Nobel Laureate, 2002

One year after the Bush dividend tax cut went into effect, what has been the short-term impact of the tax cut?

I think it helped to buoy expectations and get capital markets back on track. My only criticism is that it did not go far enough. The double taxation should end, and its end is long overdue. To me it should not even be a political and partisan issue.

What will be the long-term impact of the tax cut?

Insofar as people reinvest dividends, it is a tax on savings and investment, and it reduces tomorrow's jobs and output. So, the long-term impact is to encourage growth from the bottom up—that is to empower individuals to reinvest more of their earnings from capital. Individuals who have income from dividends are the investors in our economic future. More general tax cuts must necessarily occur in the upper 50% of income, and this is where savings and investment come from.

Where is the U.S. economy headed right now?

We are saddled with the aftermath of a costly war. We have been there before, and we'll grow out of it. The greatest threat to the economy is the political vote-getting rhetoric of restrictions on trade, outsourcing and migration.



If you were to formulate a statement about current economic policy, what would you say?

I worry that the rhetoric of job loss will lead to crippling long-term policies. Manufacturing employment is in a long and continuing decline because we are steadily getting more for less. Outsourcing is absolutely essential for maintaining the U.S. lead in technology. Outsourcing releases resources for lowering prices and redirecting investment into new technologies.

If we shortsightedly prohibit or limit outsourcing, our international business competitors will still outsource. This will simply bankrupt more of our businesses, and we will lose the jobs anyway. The political process responds only to the loss of yesterday's jobs, not to tomorrow's jobs, because the latter is not in any politician's identifiable constituency.

If a new administration were to take office, what should its first priority be on the economic front?

Priorities should be free multilateral trade and more lenient policies toward immigration. The war on terror is making it harder for post-docs and scientists to enter the U.S. In addition, a new administration should focus on lowering taxes, particularly on capital, and reducing restrictions on businesses that limit innovation and entrepreneurship.

What are the main differences between the Bush and Kerry economic platforms? Which is better for the U.S. economy?

On the above issues, both candidates are a mixed bag in terms of what they are willing to say publicly.

We saw the crossfire that Mankiw was caught in, yet both Democrat and Republican economists agree with him. [The chairman of President Bush's Council of Economic Advisers, N. Gregory Mankiw, had said outsourcing was good for the U.S. economy in the long run.] For me, the fact is that it is a plus for Bush. But Bush is forced to equivocate or risk vote loss. I don't like to see Kerry exploit this issue, but that's the way it works.

What is your opinion of Sen. Kerry's plan to repeal some tax breaks on high earners and use the money for deficit reduction or health-care initiatives?

Bad policy. Some 96% of taxes are paid by the upper 50% income-tax bracket. Take more and you risk reducing savings and investment. No one gets anything if there isn't anything. Productivity, innovation and wealth creation is the only source of poverty reduction and human betterment. [Those in the upper income brackets] should be allowed to do their thing, and not be invaded.

Bad policy. Some 96% of taxes are paid by the upper 50% income-tax bracket. Take more and you risk reducing savings and investment. No one gets anything if there isn't anything. Productivity, innovation and wealth creation is the only source of poverty reduction and human betterment. [Those in the upper income brackets] should be allowed to do their thing, and not be invaded.

Robert M. Solow

Nobel Laureate, 1987

Where is the U.S. economy headed right now?

As far as we can tell, we started very weakly at the end of 2001, at the beginning of the recovery from the recession, especially with no increase in employment, and, in fact, a continued reduction in employment. Then there was a period of several months in which employment picked up and businesses were creating jobs in reasonable numbers and the level of output, the GDP, was rising. Then in late spring, there appears to be another slowdown. I don't think that too much should be read into that. My own theory is that we are having a considerably slower-than-average upswing after the end of a recession, but there is not really any sign that it is coming to an end.

If I had to guess, I would expect it to continue at roughly this pace for at least a little while. There doesn't seem to be any reason for a dramatic slowdown or speedup from what we have now. I think that politically we will go into the election with an economy that is not a disaster at all but an economy that is not a great success.

The Democrats have a strong case, if they can make it in a way that will interest the voting public. I think that the failure of the Bush administration on the employment front is worse than appears in the normal discussions in the press. If you simply look at the month-by-month employment figures, there have been five or six months of increasing employment. A couple of months were pretty good and the most recent figure was not very good, but it was still an increase.

Superficially, it seems that employment is rising, if not dramatically. But, in fact, a much more important concept is what is called the employment-population ratio—the fraction of the population of working age that is in jobs and actually employed. The remaining people are unemployed but are technically not in the labor force.

There's a well known thing that when people cannot find a job they stop looking. When they think there's not a job to be found in their neighborhood, they don't look. They're technically not considered unemployed.

If you look at the employment-to-population ratio, it has fallen by several percentage points from the peak just about the time Bush took office. If you ask how many jobs would be needed to bring the employment-population ratio back to where it was when Bush became presi-

dent, it would be about four million—a good 3% of the labor force.

So the labor-market situation is not even as good as it looks. It's considerably worse.

If you were in charge, what would you do right now to stimulate the economy?

I hesitate doing anything right now for short-term purposes that would increase that deficit. I think that Kerry is on the right track if he can make politically accessible the idea of taking back, of canceling, the Bush tax reduction as it applies to those with the highest incomes, and then redirecting that, partially to budgetary consolidation, but even more to generally stimulative purposes like temporary grants in aid to the states. I don't know how much revenue could be recaptured by canceling the tax reductions on the highest one, two or three percent of incomes, including Mr. Clinton and including myself. There may be several hundred billion dollars that he could use, partially in deficit reduction and partially in genuinely stimulative employment-increasing activities.

Is there anyone who deserves the Nobel prize and hasn't gotten it?

If I tried to rank all the living economists, I would have to put Edmond Malinvaud, a Frenchman, at the top. He's about my age, which is about 80, so I hope that if the Swedish Academy is ever going to give Malinvaud the reward he deserves, they do it soon.

Joseph E. Stiglitz

Nobel Laureate, 2001

One year after you signed a statement with nine other Nobel laureates criticizing the Bush dividend tax cut, what has been the short-term impact and was your criticism correct?

The predictions were fairly accurate. There has been no evidence that [the dividend tax cut] has had any effect. The concerns at the time are still relevant—namely that most Americans have most of their stock in pension funds and IRAs, and they don't pay taxes on their dividends. So, it's not a tax cut for most Americans, only a very small fraction. It's for those whose money is not in retirement accounts—those who inherited money or have more money than they can put into their pension funds.

The result is that by lowering interest rates to record low levels, the refinancing of mortgages was stimulated, not investment. If you have excess capacity in fiber optics, lowering interest rates is not going to induce you to invest more in fiber optics. These basic points are still true. What makes room for a debate is that every economic downturn comes to an end, and this has been a longer downturn than the typical downturn. Eventually, the computers get obsolete, and companies need new software. They will need new investment, but that has nothing to do with the dividend tax cut. The advocates will say investments did increase—but we knew that it was going to increase eventually.

In the 1990s, so much of investment was in high tech that the market reacts quickly. But there's no evidence that [the reaction] is related to the Bush tax cut. It will take time to assess whether some subtler points played a role.

The dividend tax cut could actually act to discourage investment in the longer term. The reason is the following: Much of the recent research from the past 10 years shows that cash flow and credit availability play a role in investment. There are periods in which companies can borrow very easily and invest. Retained earnings become an important part of future investment [calculations], and the dividend tax cut encourages firms not to retain earnings. So, there is an argument that the dividend tax cut could discourage investment.

The dividend tax cut clearly benefits relatively few people. One other thing at the time we signed the letter was an argument about double taxation. Many of us said if you worry about double taxation, there are ways of dealing with double taxation that maintain progressivity. What was striking here was that the dividend tax cut was aimed at getting rid of progressivity, not at double taxation. Why do it this way? Particularly because we had already eliminated double taxation for most Americans, but then some of us said there's an issue of zero taxation—i.e., corporations that don't pay the corporate income tax. In the past, we caught them at the dividend level, but now you exempt them on dividends.

Any other observations?

I think our energy policy is disastrous and has considerable international political consequences. And our economic policy has broader consequences. In terms of our energy policy, we should have been focusing on energy conservation. There are the environmental consequences, externalities as economists call them, that Bush doesn't understand. Bush tried to pretend that he was a better scientist than all the scientists who have come to agreement about the risks of global warming. And now the National Academy of Sciences supports [conservation]. There really is a need for conservation policy.

The policy of trying to increase the extraction of oil is not only bad for the environment, but it jeopardizes our future. I call it the "drain America first" policy—take oil out of America and leave us more dependent. At least now we have some reserves. It jeopardizes our future security. To me, it is a reckless policy. ■

Laureates on the U.S. Economy

George A. Akerlof

Nobel Laureate, 2001

Why is this a rather weak recovery?

The stimulus package for recovery was poorly designed. It was much too heavily weighted to tax cuts for those people who don't have a high propensity to spend, and secondly, the stimulus package promised—either implicitly or explicitly—very large tax cuts down the road for a continued period of time. That tends to raise long-term interest rates. Such increases can have effects so strong that they can even reverse a stimulus. A properly designed stimulus would have focused on short-term tax cuts.

What short-term taxes would you cut?

Straight income tax and since the propensity to spend is higher in the middle class, I'd give more to the middle class. Another form of tax incentive that would give a quick stimulus would be increases in the earned income tax credit.

If you were to formulate a statement about current economic policy, what would you say?

The most important thing is that there are very large deficits—as far as the eye can see. I cannot name a time in our history when the deficits into the future have been so large. We've had very large deficits in wartime, for example in World War II, but there was the assumption that when the war ended we would pay back that deficit or the economy would improve. With the deficits such as they are, one actually does not see that.

The question is why is this such a serious problem? A lot of people have focused on the tax cuts for the wealthy. I see that as a potential problem, but also I see another problem as yet more important.

The ultimate emergency weapon to get out of a depression is the ability to use fiscal policy to stimulate the economy. At some point, if the deficits become sufficiently large, or if the aggregate debt becomes sufficiently large, then you cannot use fiscal policy anymore because the bond markets aren't going to take on the bonds without very high interest rates.

What are some of the biggest ideas that are emerging in economics?

One of the most exciting things com-

ing out right now is behavioral economics—the merging of psychology and sociology with economics. This is giving us an economics that is both new and subtle.

Some economists are also doing some wonderful work in statistics and looking at natural experiments. They're using near-experimental evidence in ways that are very similar to what is done in the natural sciences. I'm always amazed at how good my junior colleagues are at being extremely inventive.

Can you give me an example of such a natural experiment?

David Card wanted to look at the effect of increases in labor supply on unemployment and wages. In 1980, a large number of Cubans settled in the Miami area via the Mariel boat lift. David looked at what changed after that—what happened to wages and unemployment. This is a specific example of what people are doing to examine the effects of things like changes in supply and demand.

Milton Friedman

Nobel Laureate, 1976

In an article that you wrote in The Wall Street Journal in January 2003 about President Bush's plans for a dividend tax cut, you said you weren't sure what the short-term impact of the total tax package would be. Now, roughly one year after the dividend tax cut went into effect, what is your opinion?

The dividend tax cut has been having the expected results. It has eliminated the former bias for corporations to plow back earnings rather than distribute them to stockholders as dividends. As a result, there has been a substantial increase in the payment of dividends. The end result will be a more efficient distribution of capital.

Does Microsoft's plan for a special dividend basically prove your point?

Yes. Microsoft does all the research and development it sees as efficient, and it's still accumulating liquidity. Better for that to be in the hands of the stockholders to spend or invest.

Where is the U.S. economy headed right now and why?

The economy will keep on growing slowly, and sooner or later we'll have another recession. No economy has been able to avoid all recessions. The basic thing is that the U.S. economy is in better shape than it has ever been.

Look at the key variables. Real per capita income is almost surely higher

than it has ever been. Inflation is low and stable. Interest rates are low and stable. Unemployment, at about 5.5%, is below usual levels for such a period. The economy is doing very, very well. What people are complaining about is that the recession wasn't deeper.

That the recession wasn't deeper?

Had the recession been deeper, the current recovery would be stronger. When you have a mild recession, you tend to have a mild expansion. When you have a severe recession, you tend to have a vigorous expansion.

If you were to write an open letter to the Bush economic team, what would your advice be?

As it always is—spend less, tax less and regulate less. I am in favor of tax cuts of almost any kind. The Bush tax cuts are, on the whole, very good.

What about the argument some make that the tax cuts favor the rich?

The tax cuts did favor the rich because the top 1% of taxpayers pay a disproportionate amount of taxes. You can't give tax relief to those who don't pay a lot of tax. This is not a bad thing. What in fact do the rich do with their money? They can only consume a limited amount. In practice they end up either investing it or giving it away.

What are the main differences between the Bush and Kerry economic platforms? Which is better for the U.S.?

First of all, it's hard to know what either one is pushing. I think Mr. Kerry has promised lots of things he would not be able to fulfill. His proposed changes in health care would be expensive and counterproductive.

Bush's health savings accounts, which give individuals tax advantages for spending on health, will reduce the number of uninsured people. Essentially, it provides for cheaper insurance and eliminates third-party payments.

Kerry has proposed higher taxes and higher spending. I believe both are bad.

Bush's program of making tax cuts permanent and his proposals for personal savings accounts for Social Security are good. One of the unfortunate things was his steel tariffs, but those have been repealed, and now he seems to be pushing free trade. This is a good development.

