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Author

Boskin, Michael J.

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Learn, Earn, and Serve

Michael J. Boskin

T.M. Friedman Professor of Economics
Senior Fellow, Hoover Institution, Stanford University

May 1996

Commencement Address to the Economics Department, University of California, Berkeley at the Hearst Greek Theater, May 17, 1996.

LEARN, EARN AND SERVE
Commencement Address to the Economics Department
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Michael J. Boskin
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I am deeply honored to be here today, both to share this joyous occasion with, and to make a few remarks to, the class of 1996, and friends, family and faculty. CAL is a **great** university — a state, national and world resource. It attracts the best and brightest faculty and students to come together to learn, to explore, to research. Today's CAL students will be tomorrow's leaders in business, the professions and public life. But perhaps I am biased — I spent seven of the best years of my life here.

So let me begin first and foremost with a warm and heartfelt congratulations to all of you on a job well done. Your diploma is a testimonial and a capstone to

hard work in a demanding and challenging environment. You should be proud of your achievement and allow your parents, other relatives and friends to be proud of you for it. Years from now you will remember today and cherish this celebration.

I recall quite vividly my own graduation — up the way in Memorial Stadium. I wasn't even going to go, but my parents insisted. It was one of the best decisions I ever made, for reasons I hadn't been sensitive enough to imagine. Meeting my parents after the ceremony, pictures and hugs ensued. But what I remember most to this day are the tears that kept rolling down my father's face. The son of immigrants, he had to drop out of college to work during the Great Depression and never had the opportunity to return. I was the first person in my family ever to graduate from college. Until the moment I saw my father crying, I had not fully realized how remarkably important my education was to him. Those moments strengthened bonds and healed wounds in a magical way. When I think of my father, long since deceased, it is almost always that image of him I recall.

I hope in addition to all the courses, exams and term paper deadlines, you found time to have some fun, learned a lot about yourself and made life-long friendships. I certainly did and treasure each to this day. I hope also that you have been inculcated with the scientific method taught in economics that derives implications of theories and tests them with real facts and hard data, rather than with

emotional appeals, simplistic slogans, and sophistry. And I also hope you have developed a respect for learning that will lead you to value it for yourselves, your children, and society. Indeed, I cannot think of a single day in my adult life during which I have not learned something, most of it useful. May each of you experience that unique joy for decades to come.

While I hope your future will include continual learning, it will consist in much greater measure of earning a living and raising a family. Your parents undoubtedly are delighted by those prospects. Regardless of your chosen pursuit and how it evolves and changes over time, may you do well. You will undoubtedly contribute much in your business career and family life. Participating in building a business, creating jobs and opportunity, and supporting and raising a family, inculcating your children with time honored values such as honesty, integrity, hard work, tolerance and compassion are perhaps the most important things most of us do in our lifetime. By not dwelling on these great challenges themselves, I do not mean to suggest in any way that they are less than personally important and socially vital.

But after you have learned and earned, if I may make a personal appeal, serve, whether on a school board, helping a private charity, or in government service. One hears much disgust with government and with politics these days,

much of it deserved. Pundits proclaim that younger voters are quite cynical. I have had the privilege and opportunity to devote part of my life to public service, in fact, I still do, and want to let you know that it is possible to make a contribution to something larger than yourself and your own self interest — important as those are — and to do so honorably and honestly. And it is possible to make a measurable difference in the lives of your fellow citizens.

As you set off on various pursuits, finding a full time job, preparing for graduate or professional school, taking a well-earned vacation, let me share with you some personal reflections on the evolution of the American economy since I graduated from Cal and some conjectures about what will confront your generation.

We hear so much these days about declining standards of living, the likelihood that the next generation will be worse off than we are, that it is important to rebut this overly pessimistic declinism. Certainly there are still serious problems facing individual families and the country. But tremendous progress has been made.

I graduated from CAL in 1967 - President Kennedy had been assassinated during my freshman year and President Johnson had just pushed through the Civil Rights Act and Great Society programs, establishing Medicare and launching the War on Poverty.

The economy had been growing at a supernormal pace for two decades following World War II. Naive extrapolation of these trends into the distant future made everything seem attainable and the cost of obtaining them inconsequential. With hindsight, the suppressed demand from the Great Depression of the 1930s together with the readily available technology from World War II created unusually propitious conditions for American economic growth that propelled living standards upward at an unsustainable pace.

The notion that the government was the likely solution for many of our problems was ascendant, but productivity growth was about to collapse and terrible inflation about to commence. Some take the slowdown in the rate of economic growth and the slower improvements of living standards as a sign of serious fundamental decay or decline in the American economy. While I do believe the economy is capable of doing better than it has in recent years, the notion that the American economy is in a long-run structural decline — what I would call the myth of America's decline — advanced in the last decade by academic and media pundits is simply wrong. These pundits clamor for expanded government spending programs, protectionist trade policies, and government subsidies for special commercial technologies. The declinists insist that America is lagging behind its economic competitors (until their own recent problems, especially Japan and

Germany), is de-industrializing, and that economic collapse is just around the corner.

Well, the American economy does, indeed, face serious challenges, most importantly raising productivity growth, the foundation of rising living standards. But even with the healthy discount for political hyperbole, these allegations are nonsense. America remains the world's largest, richest and most productive economy. With less than 5 percent of the world's population, it produces almost a quarter of the world's total output of goods and services. The average standard of living in America exceeds that of any other leading industrialized country, 20 to 30 percent higher than in Germany and Japan. Productivity is also higher — about \$10,000 per worker per year — as is average private sector pay — than in these other nations.

While the fortunes of particular industries have ebbed and flowed, America is not de-industrializing. Manufacturing's share of total economic output has been roughly constant for the last 30 years, and America today accounts for an even larger share of the industrial output of the developed OECD countries than it did in 1970.

Neither is America losing its overall competitive edge. America is the world's leading exporter. Although many U.S. manufacturers face stiff competition in

markets with high volume and low profit margins, America has maintained or enhanced its technological edge in areas such as microprocessors, advanced telecommunications, software, biotechnology, aerospace, chemicals, and pharmaceuticals.

The American economy is currently also faring far better cyclically than those of the other leading industrialized countries, each of which is at or near recessionary levels.

I do agree with the pundits of decline on one point: America will not remain the world's strongest economy unless productivity growth improves substantially. Although productivity growth depends primarily on private decisions to save, invest, innovate, start a business and develop skills, public policy also matters. America saves and invests too little. The federal government spends and borrows too much. The elementary and secondary education system is woefully in need of reform. The tax system impedes entrepreneurship, saving and investment. Federal, state and local governments regulate too much private activity too inflexibly. The legal system imposes vast unnecessary costs on consumers and companies, and stifles innovation. Too many Americans depend on a welfare system that penalizes work, saving, and intact families. Add to these numerous social problems with important economic ramifications such as rampant crime and teenage pregnancy, and the list of problems

is certainly large enough for everyone to find fault with something. But much progress has been made.

While worker compensation has been growing more slowly for the last 20 years than the previous two decades, the American economy has been flexible and dynamic enough to provide employment to virtually all those who seek it. Compare that performance with the sorry state of Western Europe, where the unemployment rate is now 11 percent, double that in the U.S.

There were 30 million more working-age people in Western Europe in 1994 than in 1970. The labor force however, grew by only 19 million, and unemployment and government employment swelled. As a result, there were 1 million fewer private sector employees in Western Europe at the beginning of 1994 than at the beginning of 1970! What a stark indictment of an inflexible, protectionist, highly regulated and overtaxed economic system. By comparison, there were 40 million more working-age people in the United States, the labor force grew even more, and despite a small increase in unemployment and government employment, the overwhelming bulk of the workers found productive private sector employment. The sorry state of Western Europe offers us a window on our own future, a point to which I will return.

The earnings premium for highly-skilled, educated workers has increased dramatically. The immense increase in the supply of low-skilled workers from economies previously cut off from the global trading system — perhaps 1 billion workers in China and the former Soviet empire, for example — puts downward pressure on earnings opportunities for low-skilled workers in the United States. Under-reported has been the big shift in the composition of output towards goods and services which have a higher knowledge content — and which require more knowledge-intensive workers to produce. This is true not just in high-tech industries like computer hardware and software and biotechnology, but even in traditional goods and services such as automobiles. A much larger fraction of the value added in a car in 1996 is derived from the application of human capital — knowledge and skills — relative to raw labor than was the case, say, in 1976. From the sophisticated electronics to the aerodynamic design, to the lighter-weight materials necessary to improve fuel economy, there has been a fundamental shift in the share of output that derives from knowledge and skills. That is good news for each of you — at least for the time being. It is hard to predict what sorts of skills will be in increasing demand a decade or two from now — so continue learning. And don't forget those who are not fortunate enough to have your skills and education.

Let's see how typical American families lead their lives now, compared to a generation or two ago. In 1960, 41 percent of adult Americans were high school graduates and 8 percent were college graduates. Today, those figures are over 80 percent and 20 percent, respectively. Industrial production — the output of the nation's mines, factories and utilities — is 350 percent higher than in 1950. Over a third of American homes today have personal computers and about 60 percent answering machines. When I graduated from CAL, neither product existed. Add VCRs to that list. A typical supermarket carried about 5,000 products in 1967. Today it carries more than 30,000 — new types of healthier, fresher food among them.

Looking back still further, at the outbreak of World War II, more than 1 in 5 Americans lived on farms, less than one third of which had electricity and less than 10 percent of which had flush toilets; more than half of American households did not have a refrigerator; and about three-fifths lacked central heating. Homes were primarily heated by coal and wood, with all the pollution that generated. Almost one in three households did not have running water. Conditions which today we associate with tragically poor underdeveloped economies afflicted a sizable fraction of Americans just two generations ago.

While low-skill workers face difficult challenges in the years ahead and as a society we face difficult economic and political challenges about what to do about that, some traditionally disadvantaged groups have made impressive, if incomplete, progress. For example, women have closed one-quarter of the pay gap with men in the last 15 years, at a time when there was a huge expansion in female labor force participation. Likewise, the relative economic condition of the elderly has improved remarkably in recent decades. The income of the elderly now is equal to that of the general population, and the elderly who three decades ago had the highest incidence of poverty, now have a poverty rate slightly below average.

Reality, of course, is more complex. Despite spending trillions of dollars on the War on Poverty, the poverty rate today is virtually identical to 1967, the year I graduated from CAL. The Great Society programs started by President Johnson and expanded by President Nixon now combine with demographic trends that will cause serious economic disruption and political difficulty in coming decades. The post-World War II baby boom generation will be heading into retirement in about 20 years. Combined with the increased life expectancy of the elderly, which has been rising about one month a year for 30 years, this will place huge strains on the future of social security, private saving, the federal budget and taxes. The increase in the

tax burden on **your** generation will be immense unless **my** generation has the will to slow the growth in these entitlement programs.

The current budget battle in Washington is but a tiny warm-up act to this far larger problem. By the year 2002 Medicare is projected to spend 1 percent more of income than it takes in and be bankrupt. Twenty or 30 years later, Social Security and Medicare will be 10 to 15 percentage points of taxable payroll in the red — requiring a doubling of payroll taxes up to European levels or a drastic reduction in benefits. I just mentioned the terrible impact European level tax rates have on their economics. Can anyone be so selfish as to wish that on your generation when mine retires? The intergenerational equity of taxing workers to pay benefits to retirees is far more compelling at times of rapid growth that makes each successive generation far richer **and** when the elderly are disproportionately poor — conditions that prevailed when I graduated from CAL — then when growth is slow and the elderly are far better off — conditions that prevail today. A large part of what will determine **your** economic future will be how **we** deal with this vast demographic transition.

Finally, let me mention briefly what I believe to be the most important transformation in the years since I graduated from CAL. I graduated a few years after Soviet Premier Nikita Khrushchev shouted to an American president “We will

bury you!” Khrushchev was not talking about military might. He was projecting the growth of the Soviet economy relative to the slower growth of the American economy. Khrushchev proclaimed that the Soviet economic system with its central planning, bureaucracy, controls and state enterprises was a superior economic engine.

Little did I know as a CAL economics undergrad that a couple of decades later President Bush would dispatch me to Moscow to help Gorbachev with Soviet economic reform. When I arrived in Moscow in 1989, in addition to Gorbachev, who knew very little economics, I met with the head of the state planning agency, (Gosplan), the Finance Minister, and the head of the Central Bank.

The head of Gosplan was supposed to preside over price reform in the Soviet Union. Instead of administered prices, there was supposed to be a move to a free market. At our first meeting he inquired of me “Who sets the prices in your economy?” Flabbergasted at this remark, I explained that while we had a few industries that were regulated by government, for the overwhelming bulk of products the interaction of numerous producers and still more numerous consumers determine prices in our economy, and furthermore, repeating Adam Smith’s famous dictum, this invisible hand of the market produced the greatest good for the greatest number. The head of Gosplan repeated “So who sets the prices in your economy?”

Thinking that there might have been something wrong with the translation, we went back and forth several times. It was clear he could not think of an economy in which somebody in the government did not set the prices. He pulled out a 1960s-style giant computer printout which was the price list for virtually every product in the Soviet Union. America had a market economy, I was the American President's economic advisor, he had been told by Gorbachev that I would help, so who, he thought, was better able to determine what the new prices should be?

I next went to the Finance Ministry where I discussed making the ruble convertible with Finance Minister Pavlov, who subsequently became prime minister and was involved in the coup against Gorbachev. After a similar to-ing and fro-ing, trying to explain concepts, Pavlov motioned for me to wait in his office in the Kremlin and disappeared through a secret door behind his desk. Remember, this was when there was still a Soviet Union, a Warsaw Pact and a Communist Party. A few minutes went by and I started feeling a bit like a character in a Robert Ludlum novel, worrying that no one at the Embassy knew exactly where I was. Eventually, Finance Minister Pavlov returned and handed me a little case and motioned for me to open it. Inside was a coin. And there was the first Soviet version of the convertible ruble. A coin that said on one side 1 ruble and on the other side 1 dollar. Well, I've won teaching awards in my day, but I knew I had a long way to go.

Needless to say, when I returned to Washington and debriefed the President, the Treasury Secretary, the Fed Chairman, the National Security Advisor and the CIA Director, I was pretty pessimistic about Gorbachev's chances of pulling this off, and about Soviet economic reform. Its going to be a rough road I said, think in decades, not years, and this group can't possibly pull it off. Either they'll be gone, or there will be a political backlash that stops the reforms.

My personal journey is echoed in the intellectual and historical experience of the last quarter century. Back in the 1960s, 70s and 80s — and I am told occasionally still on some college campuses — a prevailing view was that the world's social and economic systems would somehow converge toward a central tendency, somewhere say, to the left of where Sweden was in the 1970s. The communist economies, it was said, would round off some of the rough edges by allowing a littler freer reign to private incentives, whereas the advanced capitalist economies would evolve into ever larger welfare states with more government planning, intervention and control in their economies. We would all happily converge roughly on the same system, with roughly the same results.

Well, history has performed that experiment. Compare the former East and West Germany (which when I was in the government, we helped unite, remarkably, inside NATO while there was still a Warsaw Pact and an intact Soviet Union). Both

were shattered by World War II. Both had similar problems and opportunities. One was dosed with communism — the heavy hand of state planning, controls and government intervention, regulation and state ownership of virtually everything. Once the Erhard reforms created a currency in which people had confidence and freed up prices from post-war controls, West Germany was dosed with capitalism. The West grew into an economic superpower — struggling now under the burden of economic integration with the East — while the East stagnated. When the two Germanys were reunited, the standard of living in the West was five times that in the East, which had a spoiled environment, decrepit capital stock and demoralized labor force. Indeed the saying among East German workers was: They pretend to pay us and we pretend to work. That is about as close as we get to a natural experiment in economics. And the answer is unambiguous.

We have witnessed the most important event in the last half century — the collapse of communism. There is no longer any doubt about whether there are two alternative paths to economic prosperity. Socialism and central planning do not work. Only capitalism and free markets, despite their problems, do work.

From the development of personal computers to the collapse of communism to the changing role of women in the economy and society, to name but a few, it has been a remarkable journey from my graduation to yours. I have no doubt that

looking back years from now when you will be attending the graduation of your children, hopefully from this great university, you will feel likewise.

We can forge a better future for our country and for all Americans. A future bright with promise for ourselves and our children as we enter the next millennium. My own personal opinion is that to deliver on that future bright with promise we must choose individual freedom, liberty and opportunity over government bureaucracy. Less rather than more government spending. Lower rather than higher taxes. Faith in the American people (all of them I might add) — in their strength, goodness, fairness and common sense — over faith in larger, more intrusive and more expensive government that stifles freedom and opportunity.

Some of you will agree, some of you will disagree with my particular policy conclusions. What I ask of you today is not agreement — but a commitment to engagement. Democracy is not a spectator sport. I hope each of you will find something in you — in your sense of values, your family ties, your religion, or just your own personal sense of justice, decency and honor, to take time out of your private pursuits to participate in solving some of the nation's problems. Your economics education will be one important tool for doing so. To quote one of the greatest of all economists, Alfred Marshall: "The answer to these questions does not depend only on economics. It depends, in part, on the moral and political

capabilities of human nature and on these the economist must do as others and guess as best he can. But the answer depends in large measure on facts and inferences which are within the province of economics and these are what gives economics its chief and its highest interest.”

As the old saying goes, “An oriental wiseman used to ask the divinity in his prayers to be so kind as to spare him from living in an interesting era.” Perhaps we are not wise, as we have not been so spared. We are living in an interesting era that compels us to take an interest in issues and events well beyond our own personal lives. Engage in them. But, in doing so, try never to let criticism descend to insult. Grant that those who disagree with you may be right from their perspective and that in any case their reasons, even though wrongheaded to you, may be their honest and best assessment.

Let me close by transposing Adam Smith’s famous dictum about the social benefits of the invisible hand of the market in quoting the great French existentialist, Nobel Laureate author and playwright Albert Camus. “Great ideas, it has been said, come into the world as gently as doves. Perhaps, then, if we listen attentively, we shall hear, amid the uproar of empires and nations, a faint flutter of wings, the gentle stirrings of life and hope. Some will say that this hope lies in a nation, others in a man. I believe rather that it is awakened, revived and nourished by millions of

solitary individuals whose deeds and works every day negate frontiers and the crudest implications of history. As a result, there shines forth fleetingly the ever threatened truth that each and every man, on the foundation of his own sufferings and joys, builds for all.”

Congratulations. Good luck, God bless you. And Go Bears.



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