

The Principles Behind the Policies

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The Principles Behind the Policies

Q. Since this is the first interview of the new *Challenge*, I hope you'll say some things that will make our readers sit up and take notice.

A. That depends on the questions you ask me.

Q. That seems fair enough. How did your path lead to this office? How and why did you become an economist?

A. I decided to become an economist in 1933 when I was in college and choosing my major. I had a choice then among a number of things, but economics was a subject of great interest in the depths of the depression. Everybody was concerned about the economy, and I had very personal contact with the problem of unemployment. I lived in an industrial city, Schenectady, New York, where there was a lot of unemployment. My father was unemployed a good deal of the time, so this was a problem with which I was intensely concerned. I took up the study of economics as a college student, and I've been at it ever since.

Q. On balance, are economists a help or a hindrance to the economy and the nation?

A. Oh, I think they're a great help to the economy and to the country. I think there are lots of questions that we don't answer very well, but I think that the generally high level of stability of the American economy since the end of World War II owes a great deal to economists. I think that economists also have contributed much to the appraisal of particular issues, like pollution, education, and so on. The way economists think about problems has contributed a good deal.

Q. I'd like to ask you how economic policy is made

in this Administration. Recently a Council on Economic Policy was set up, which is headed by Secretary of the Treasury George P. Shultz. What is its relation to the Council of Economic Advisers and other economic bodies in the Administration?

A. The Chairman of the Council of Economic Advisers is a member of the Council on Economic Policy and so are most of the heads of departments which have important economic functions. So too are members of the Executive Office with important economic functions, like the Director of the Office of Management and Budget. The process of economic policy formation in this Administration since I've been here—that is, since 1969—has always been one of interagency consultation. There are very few important economic problems that do not cut across the interests of more than one agency. Moreover, as far as the Council of Economic Advisers is concerned, we are, as our title suggests, purely advisory. As my professor Jacob Viner used to say, the expert should be on tap, not on top; and our ambition is to be on tap. We never had any thought of being on top. But, anyway, what is important for us is that we be a part of interagency consultation and decision-making so that we can make our contribution to it. Now a very small number of quite major economic questions come to the President. Mostly, things are resolved by the heads of the agencies primarily involved. When a high-level economic question comes to the President, such as the institution of the freeze, or the shift to Phase II, or the shift to Phase III, or what our overall budget strategy should be for the next year, here the President gets advice from a number

of people, including the Council of Economic Advisers. These people have always had a lot of discussion before the President hears from them, but he may hear conflicting views. If the issues remain unresolved, he makes a decision.

Q. Just briefly, how does the Council on Economic Policy change the setup from the way it was before it was established?

A. The Council on Economic Policy really formalizes and somewhat expands the arrangement which had previously existed. The previous situation was that we had a network of committees of overlapping membership. Membership was determined by the subject in question, with the Secretary of the Treasury the common denominator of all the committees, since he was on all of them, generally as Chairman. The Council of Economic Advisers was also represented on all of them, but with other people floating. For example, the longest standing of these committees is the troika—the Secretary of the Treasury, the Director of the Office of Management and Budget and the Chairman of the Council of Economic Advisers. They deal with overall financial policy and the management of the overall level of economic activity insofar as the government manages it. Then there is a somewhat larger group: these three people plus the Chairman of the Federal Reserve, which constitutes the quadriad. Another group deals with international economic policy; yet another more specifically with international monetary policy. The Cost of Living Council deals with the price and wage control system. The Secretary of the Treasury has been at the center of this network of interlocking committees, and that remains the situation. I think that is essentially the way the new Council on Economic Policy will operate. It will be a holding committee for all the various more specialized committees dealing with special problems. I doubt that the Council on Economic Policy as a group will meet very frequently. But under its aegis a great deal of work will go on.

Q. How do you assess the economic performance of the Administration in the last four years? What are your triumphs, and what are your defeats?

A. I think that our triumph is in finally having gone a long way—I won't say we've gone all the way—but we've gone a long way to liquidate the consequences of the big inflation that went on from 1965 to 1968. The victory has been in turning down the inflationary pressure in the first place without

getting a very serious recession; and then in bringing about a quite substantial recovery in the second part of 1971, in 1972 and into 1973 without reviving inflation. In fact, the inflation is continuing to decline. I think that the rather satisfactory management of a price and wage control system for a year and a half has been a triumph. When we started this system a lot of people said that it was most anomalous; I guess they used stronger words than that. Bob Nathan said it was like putting a preacher in charge of a whorehouse. But anyway, some people thought it was quite anomalous to have a group of us who were known not to be fans of price and wage control be in charge of running it. That was a mistaken view. It has run very well and has been a triumph of a sort. On the other hand, the economy declined further; in 1970 and early 1971 unemployment was higher, and the inflation rate was higher than we had expected. I think we did make a mistake in underestimating the durability of inflation, and that had a number of consequences. We probably made another mistake—although this is not quite so certain—in not turning onto an expansionary path earlier—say in the middle of 1970. But by and large I think ours was a good performance.

Q. John Kenneth Galbraith, not known as a supporter of this Administration, advocated wage-price controls for years before the Administration adopted them. Do your actions vindicate his analysis of administered inflation, that is, inflation caused by the market power of big corporations and big unions?

A. Well, I think there is a fundamental difference between our view and Galbraith's view. We believed the situation that we were dealing with was a temporary one arising in a certain historical context and that the steps we took to deal with it were also temporary. The move that we've made to Phase III now is a move on the way out, and we are not impressed with the Galbraithian prescription as a permanent prescription for running the American economy. Moreover, we don't believe that the administered price sector of the economy is necessarily the sector that is dynamic and leading in causing inflation. As we look at our performance in the last year we find that the prices in the private nonfarm sector have risen very little. And that can't be explained entirely on the basis of controls. In many cases prices are below the ceilings. These

sectors are not aggressively pushing prices up. They aren't the ones where we've had the most problems. We've had the most problems with food and health and construction, none of which is dominated by large firms. In the construction case there are some large unions, but even they aren't among the largest.

Q. What conditions are necessary in order to remove controls?

A. We want to achieve a lower rate of inflation than we now have and we want to achieve a general and more firmly based expectation that the rate of inflation will remain at a lower level than at present. I think that would be the essential test.

Q. The wholesale price index has risen dramatically. What's your reaction, and what policies are necessary to cope with it?

A. The rise in the wholesale price index has been overwhelmingly the rise of food prices. Industrial prices at wholesale have been rising very little in the last few months or in the last year. So we are making a major attack on the food problem. We are making that attack mainly from the side of taking measures to increase supply. We have reduced restrictions on the acreage devoted to production of feed grains and soybeans; we have expanded the acreage available for the production of wheat. We have taken vigorous steps to get commodities out of the government-owned stocks and out of the privately owned stocks. We have taken steps to increase the inflow of food of various kinds.

Q. When do you expect to get this problem under control?

A. I think that we will see a significantly reduced rate of increase of food prices in the second half of 1973. I think it has to be recognized that the response of food supplies to policy action takes time, and there's no point in promising that anything we can do today is going to bring fully grown steer to market next month or the month after. There is a time lag here, but we are sure we will get on top of the problem.

Q. In the trade-off between inflation and unemployment, how much of each is acceptable? You abandoned the standard goal of 4 percent unemployment. Why?

A. Well I didn't abandon it. I don't know that anybody had it in any operational way, and I've certainly not espoused any higher goal. What I have said is that I didn't think it was useful to have a numerical goal with the assumption that we should get down to that number whatever the cost of doing so might be and we should not get below it whatever the possibilities of doing so might be. It seems to me that our goal with respect to unemployment depends on how many people who are willing to work on reasonable terms are able to find work. How many that would leave unemployed is something that we really don't know and will have to find out in the market. But we are pursuing a policy which is intended to push the rate of unemployment down. We have pushed the rate of unemployment down, or it has come down in any case, to around 5 percent. We expect to see it in the neighborhood of 4.5 percent by the end of this year. We would certainly like to see the rate of unemployment down to 4 percent or less, but we are warning against the idea that the economy must be pumped up, no matter what, to achieve that objective.

Q. What is your attitude toward public service employment as a way of reducing unemployment from, say, 5 percent to 4 percent?

A. The problem about public service employment is to manage it in a way that provides jobs for people who are willing to work and who are otherwise unlikely to get work. Our own experience in the last year with it has not been very encouraging, because we find that the people employed under the public service employment program have turned out to be very much like all the other employed people, not like the unemployed people. That is, they're not particularly disadvantaged people or low productivity people. Also, they have been receiving on the average fairly high rates of pay, and I don't think that is the function of a public service employment program.

Q. The proponents of a public service employment program advocate targeting it to the hard-core unemployed and having a wage rate somewhere between the poverty level and the average manufacturing level. Do you think that it can be targeted to teenagers, women, blacks and others who are on the periphery of the labor market?

A. Well, our experience with it—and this program, as you realize, is a program which is managed by states and localities; the federal government merely provides the money for it—our experience with it is that that isn't where it gets targeted. There are political processes at work in this as in most other things, and that is not the result that comes out. Furthermore, I think that the question of the wage at which people are employed under these programs is critical. I can see at least some argument, although I'm not sure of the outcome, for having a standby program for people who are willing to work for a quite low wage but can't find work in the private sector. We do have some notion of minimum income levels required to support people, and we support many of them at the minimum level through the welfare program. But that is a different thing from holding ourselves open to employ people generally at some fairly high level of wages.

Q. To pursue this question one step further, there have been some recent studies of 51 urban areas, based on the 1970 Census, which show that if you add up unemployment, part-time employment and those earning substandard wages, you get a total of 61.2 percent of the work force in those areas, which constitutes one-third of the total work force of the city populations studied. What is your reaction to these studies, and is there not a rather serious problem which needs attention?

A. The definition of substandard wages and substandard work is a highly subjective one. Our view, or at least my view, of the national responsibility is to maintain a state of affairs in the country in which there is demand for workers who are willing, as I said earlier, to work on reasonable terms. Now the definition of reasonable terms is a difficult one, but I think the reasonableness of the terms has something to do with the productivity of the worker and the willingness of other people to employ him. Somewhere in the federal, state and local systems there is a responsibility to try to raise the productivity of workers whose productivity is very low. At the federal level we have been spending several billions of dollars in training programs in an effort to do this. I think we have to continue to try to improve our policy for this result. The policies which began ten to twelve years ago have been disappointing to many of their advocates, and no easy solution to that problem has been found.

Q. The Administration is in favor of a \$250 billion federal spending ceiling. [The Administration raised the ceiling to \$268.7 for fiscal 74.] How can we possibly meet our domestic problems and hold the line on spending too? We have acute problems in the cities, public transportation, schools, housing and public services. Don't they require drastic measures?

A. We have a lot of other problems besides those. And I guess there are two things to be said about that. We have other problems that people meet out of their own incomes, and the federal government is not in the position of manufacturing money or resources. If we spend more than \$250 billion for these purposes, we have to take them from someplace else. Essentially, we have to take the money from people who earn it and who feel that they have needs which are served by their own expenditure of their own incomes. And furthermore, we have enormously increased our outlays on all these problems through many programs, with certain progress, to be sure, but without very dramatic progress. \$250 billion is a lot of money. \$250 billion is \$18 billion more than we spent last year; we will spend more next year; we will spend more the year after; but let us slow down the rate of these increases until we discover some better way to do things.

Q. Well, to pursue this on the level of priorities, in January there was a halt in the housing subsidy; and Senator Proxmire, Chairman of the Joint Economic Committee of Congress, said, "President Nixon has decided to spend several billion dollars more in bombing Asia and to spend several billion dollars less on housing. The effect is to increase the housing shortage in both Asia and the United States. That is reorganizing priorities with a vengeance." Could you comment on his assertion?

A. We haven't decided to spend several billion dollars more on bombing Asia. I don't know what Senator Proxmire knows about that. But in any case, last year we built more houses by far than in any previous year in our history. And we expect this year that we will build, not as many as last year, but probably more than any other year besides 1972. And so we think we are increasing the stock of housing in the United States at quite a rapid rate. It is not essential to the American system that the federal government should finance hous-

ing. It's a mistake to think that all good things come out of the federal government and that without the federal government, the people would not be housed or fed or clothed. Of course they are; we have a system for doing that. Furthermore, our observation of the housing programs we have been subsidizing is that they mostly do not go to very low-income people and that they have been a source of great difficulty. One thing that we should observe: people always talk about these low-income housing programs, but Congress, when it authorizes such programs, defines low income in a way which includes a very large part of the total American population.

Q. Is it possible to turn the housing program goals around and really do something for low-income individuals?

A. That is something that has to be examined as we look at the housing programs. We have found great resistance in Congress to doing this. Congress likes to talk a lot about the low-income people but always likes to legislate for the middle-income people. Moreover, there is a real question about the extent to which it should continue to be a federal responsibility. We are now giving the states and localities \$5 billion or more a year in revenue-sharing in addition to \$25 billion or more in other kinds of aid, and we believe that there is a great deal to be said for the states and localities making this kind of decision themselves.

Q. If you put the onus on Congress, are you saying that the Administration is willing to support federal aid to low-income housing?

A. I've said that we think these programs need to be reconsidered. The present cutback is made in a particularly critical budget situation, a budget situation which reflects the priorities of Congress as well as of the Administration. You can look at each program by itself and find a lot of reasons for it; but if you put all these programs together, they amount to a drain on the budget which nobody, except a few academic economists, proposes to meet by raising taxes; and the money—to repeat the very simple statement that I made earlier—the money must come from somewhere. So, I think that we are reflecting the priorities of the American people who place a very high value on not having a tax increase.

Q. What are the problems and opportunities of a

post-Vietnam economy? Will there be a peace dividend?

A. As far as the economy is concerned, we are in post-Vietnam now [January]. The total spending for the Vietnam war is now, say, in the neighborhood of six to eight billion dollars a year which, in an economy of our size, is really very small. So we have already made the adjustment for post-Vietnam. The devotion of resources to Vietnam has decreased very substantially since its peak, which was about in the fourth quarter of 1968; and we've been through that transition. We have greatly reduced the size of the armed forces; we have greatly reduced the number of workers employed in defense production; and there is not much more to go. Therefore, there is not much more of a peace dividend to be expected.

Q. Can military expenditures be cut further in the next few years?

A. I wouldn't expect to see military expenditures cut in dollar terms because we are having a very big increase in the pay of the armed forces because of the change to an all volunteer armed force, but I would expect that defense spending would decline as a share of the gross national product and as a share of the budget.

Q. What do you think is the responsibility of the government for protection of the environment and natural resources, and are there any upcoming programs in the second Administration?

A. We think the government has a responsibility in this field, and we have considerably increased government expenditures for this purpose. I think the responsibility of the federal government is to bring about conditions in which the costs of polluting the environment or depleting resources become a charge upon those who undertake this kind of action and who benefit from it, to make sure that they are deterred by having to defray the costs of their actions. The proper approach to this problem, especially the environmental problem, is to impose taxes or charge fees for the kind of behavior which pollutes the environment. That would be, in my opinion, the best way to deter the offensive action.

Q. Do you think that dealing with environmental problems will slow down the rate of economic growth?

A. That's a definitional question, and I guess I will

say “no” right off first, and then explain that I say “no” because I would include clean air and clean water and maybe quiet as part of the product which, in an ideal set of accounts, would be included as part of growth. What we are talking about is possibly not increasing one kind of product so rapidly—maybe material objects—and perhaps producing some other kind of product more rapidly—namely, clean air and clean water.

Q. I understand that the Administration wants to replace categorical grants-in-aid with revenue-sharing with states and cities. If so, how will this produce any benefits?

A. It will produce benefits because the state and local governments are closer to the people and more responsive to their needs and better able to use the money to satisfy the interests of their citizens.

Q. We take pride in the fact that we have what’s called a profit and loss system, but at various times in the Nixon Administration, a number of large firms like Lockheed have been bailed out of difficulties. Doesn’t this run against the basic philosophy of a free enterprise economy?

A. That philosophy has been compromised for the past hundred years, and I guess we are generally criticized for running counter to it by people who don’t believe in it in the first place. But obviously the government does intervene in cases where the operation of the system will cause extreme hardship. We have been protecting agriculture for forty years on the ground that exposing farmers to the market would cause excessive losses. We protect workers through unemployment compensation and in other ways. We have a system which protects us against bank failures because we realize that such failures have widespread economic consequences which hurt the whole economy. So there are cases in the business sector where the supply of critical services, or employment for a certain important group of workers, or other activities justify support. I myself would like to see this support kept to a minimum, but I’m not particularly more aggrieved by the Lockheed and Penn Central cases than by a lot of others.

Q. Does this support have a negative effect on the optimum allocation of resources?

A. It may, and in general it does; but I think that the rationale which applies in the labor and agri-



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culture cases applies as well in the business case. The rationale is that the disadvantages on the resource allocation side are more than compensated for by the benefits of not requiring people to go through a sudden, painful readjustment. That's a principle of policy which is very widely observed.

Q. One last question, which is a more or less methodological one. Are we measuring the right things? GNP is increasing, profits are up, other indicators are favorable, and yet we have many severe problems with minorities, with the cities, with transportation, with housing. Is Keynesian policy enough? Don't we also have to have policies which pay attention to the composition of output and which measure other aspects of the economy which we're overlooking?

A. Well—that's a false distinction. Nobody ever said that our concern only need be with the overall level of economic activity. I'm sure Mr. Keynes would not have said that; but nevertheless, the overall level of economic activity is terribly important; and people do benefit when it's high and suffer when it's not. Of course we do have allocational problems, and if devoting a larger proportion of the national output through government is a way to solve those allocational problems, we have been doing it very actively for the last twenty years. Certainly there are a lot of problems, and we never will be free of problems; but I think it's incorrect to say that the GNP is up and profits are up without also saying that the real weekly earnings of workers are up and the per capita real incomes of families are up, and so on. These are the sources from which people get most of the benefits they seek in life, and they should not be left out of account.

Q. But surely the GNP is not a good measure of well-being. To cite a trivial example, the more smoke we have from factories, the more cleaning bills we have; and the more cleaning bills we have, the higher the GNP.

A. I believe I made clear earlier that I don't think GNP is the only measure, or a totally satisfactory measure of well-being. But don't spurn GNP unless you're pretty sure you are getting something better than the product measured by GNP. My quarrel is not with people who object to the GNP measurement; my quarrel is with people who object to all measurement.

Q. Mr. Stein, many thanks.