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Reviews

The "New Economics": Not New Enough

Leon H. Keyserling*


Dr. James Tobin is, in my estimation, one of the most creative and informed of American economists. His literary talents match his professional abilities. His experience, including service during 1961-1962 on President Kennedy's Council of Economic Advisers (CEA), entitles him to nationwide attention, which he has justly received.

His National Economic Policy, a volume of eighteen essays written over a fifteen-year period, covers virtually the entire range of our national economic problems, including some of their international aspects. No one concerned with these problems can afford not to read this book from cover to cover.

Dr. Tobin is a distinctly "liberal" economist and citizen (let each define "liberal" as he will), and a prime exponent of the "New Economics." He holds, and rightly, that the federal budget is but an instrument of the national economy; that neither big federal budgets nor federal deficits are good or bad per se; that a large and even growing national debt may be a positive asset if wisely managed; that social considerations do and should enter into national economic policies, and that political considerations must; and that government should exert a powerful and even aggressive role in our national life.

But how "new" is all this, even with the extensive additions and modifications which the book also contains? The widespread claim (not by Dr. Tobin to any large degree) that it is all new and all good has been carried too far.¹ This excess of enthusiasm, which has characterized a good many academic economists both in and out of the public service, is relatively harmless so long as it is regarded as no more than

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a vainglorious boast that "there were no great men before Agamemnon." But it is dangerous insofar as it tends to impair objectivity and receptiveness to badly-needed innovations in national policies. For these reasons, I shall concentrate mainly not upon what Dr. Tobin says that is beyond dispute and even highly commendable, but rather upon what he says that calls for question or even strong dissent.

**Economic Growth**

Economists have given far too little recognition, either in thought or in action, to the fact that sustained and optimum economic growth (defining the optimum as the rate of growth which holds idle plant and manpower to minimum levels, while encouraging optimum expansion in plant and in labor force participation) is in reality almost the whole task of both private and public economic policy. For while we may use unwisely what we produce, we cannot use what we do not have. In addition, it is often said that optimum economic growth facilitates the allocation of sufficient resources to the great priorities of our national needs and social purposes without excessive conflict among groups or insurmountable political strain. But this statement, while true, tends to breed an unsound dichotomy between the problem of economic growth and these priority purposes. Instead, it is more useful to say that all allocations of our economic resources, including allocations to these priority purposes, involve *ab initio* economic policies; it is not a helpful distinction (although a common one among economists) to designate the allocation of resources to factory plant as an economic decision, and the allocation of resources to the human plant as a social decision. In any event, viewing the problems of the American economy over the long run, the allocation of resources which is best in terms of ultimate human or social values comes very close to the allocation most likely to sustain optimum economic growth. These conclusions are really implicit in Dr. Tobin's statement that the "overriding issue of political economy in the 1960's is how to allocate the national output," for no issue could be the overriding issue if it slighted either the problem of growth or the problem of the ultimate purposes to which the products of growth are or should be devoted.

It follows that what Dr. Tobin has to say about pathways to growth is profoundly important. About half a year before he became a member of the CEA, he stated that, to stimulate growth, we must "somehow

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2. J. Tobin, National Economic Policy (July 1960) 78 (1966) [hereinafter cited as Tobin]. Dates in parentheses indicate the time at which what Dr. Tobin said was published, as this time factor is important in many instances.
Taking first the proposal to effectuate shifts from private consumption to private investment (which is the part of the proposal honored in the observance rather than in the breach both during Dr. Tobin’s tenure on the Council and subsequently), I believe that this thesis has been and still is egregiously erroneous.

In the first place, the thesis rests on two assumptions: that the growth rate in the civilian labor force is determined predominantly by demographic factors, and especially that other variations in the long-term rate of GNP growth are determined by additions to producers' facilities (quantitative and qualitative), which in turn depend upon private investment. Consistently with these assumptions, Dr. Tobin and the Council have frequently insisted that the average ratio of private investment to GNP was too low for a number of years prior to 1960, and policies after 1960 were designed to increase this ratio in order to accelerate the rate of GNP growth.

The trouble with this superficially appealing approach is that it ignores the importance of the economic environment from year to year as a determinant of both the rate of growth in the civilian labor force and the net additions to producers’ facilities. Demographic factors may determine the size of the potential working population, but the state of the economy significantly influences in both the long and the short run the percentage of those of working age actually drawn into participation in the civilian labor force. Similarly, in the long-run as well as in the short-run, the net additions to producers' facilities depend upon the economic environment from year to year. Thus, even if in 1970 the economy is operating in a most favorable economic environment with full employment and full plant use, producers' facilities in that year will be very much lower than they would have been if the tremendous amount of aggregate economic slack between 1953 and 1966 had not occurred; the same is true of the long-term GNP growth rate, obtained by comparing the 1970 GNP with that of 1953.

The significance of the foregoing observation is this: in the context of the actual behavior pattern of the American economy during all relevant periods since World War I, the dominant factor inhibiting long-range economic growth has been the failure during many years to use reasonably fully the productive resources actually available from year to year. During the periods when such reasonably full resource use

3. Tobin 80 (July 1960).
has occurred, the necessary stimuli to adequate participation in the
civilian labor force and adequate net additions to producers' facilities
have been abundantly available. This makes it clear that the problem
of optimum long-range GNP growth is virtually the same as the prob-
lem of avoiding the degree of economic instability which leads to large
disutilization of available resources in particular years.

Avoidance of such disutilization depends upon maintenance of rea-
sonable equilibrium between the rate of expansion of producers' facili-
ties and the rate of expansion of ultimate demand for products in the
form of consumer outlays and public outlays combined. This might
be called the problem of maintaining a sustainable ratio of private
investment to GNP. And for the most part, what is a sustainable ratio
does not turn upon whether we want a higher or lower rate of GNP
growth, but rather upon changes in the productivity of capital. Since
each dollar of investment in producers' facilities in the 1960's tends to
add more to capabilities than a dollar of investment in the 1940's or
1950's (measured in dollars of uniform value), the sustainable ratio of
private investment to GNP has tended to decline. This trend is likely to
be even more pronounced in the future. Accordingly, whenever we
want to promote a higher rate of GNP growth on a sustained basis, the
solution is not to spark an ever higher ratio of investment to GNP, but
rather to encourage the equilibrium expansion of private investment
and other forms of demand. This both Dr. Tobin and the Council have
persistently failed to recognize.

This error in analysis with its unfortunate policy consequences could
have been avoided by empirical observation of the economy's actual
performance between 1953 and 1960. During that period, we experi-
enced a fairly rhythmic pattern of periods of economic upturn at a
reasonably rapid pace, followed by periods of stagnation or unsatisfac-
tory economic growth and then periods of absolute recession. Under-
lying each cycle of this recurring pattern was a rate of expansion of
private investment in producers' facilities so far in excess of the rate of
expansion in ultimate demand (as I have defined it above) that business
investment was cut back very sharply when these imbalances became
sufficiently manifest. These sharp cutbacks, combined with the more
enduring deficiencies in ultimate demand, explain the instability and
the abysmally low rate of economic growth during the period 1953-1960
as a whole. The appropriate policies for the Administration which took
office in 1961, therefore, were measures which would redress these
imbalances by stimulating ultimate demand relatively more than
private investment. But it chose instead various tax reductions and
concessions during 1962-1965, mainly in 1964, which allocated relatively far too much to the investment function, and relatively far too little to the stimulation of ultimate demand.

This conclusion as to tax policies would hold even if my analysis of the appropriate ratio of private investment to GNP were to be disputed. For to the best of my knowledge, neither Dr. Tobin nor the CEA has ever claimed that, even without the huge tax bounties granted to the investment function, investors in 1964 (or since) would have been without ample funds to induce and sustain more than adequate levels of investment, if the spur of adequate expansion of ultimate demand had not been lacking. Indeed, for a few years prior to the huge tax bounties of 1964 the retained earnings of corporations had been in excess of their actual investment outlays. Dr. Tobin and/or the CEA may have felt that profit levels after taxes were running too low to induce adequate investment. But this in itself cannot justify tax bounties of the kind granted. They would have been justifiable only if per unit profits after taxes were running too low, and no competent economist would have made that assertion as to the years in question. On the contrary, per unit profits after taxes in general were running too high, and this fact in itself contributed (through the price excesses which this trend reflected) to the inadequacy of ultimate demand in real terms. The proper remedy under such circumstances is not to increase per unit profits after taxes still further by tax concessions, but rather to use fiscal policy to expand ultimate demand.

The unfortunate consequences of a misconceived fiscal policy became very clear in 1966, and even clearer by early 1967. Until the slight recession in GNP during the first quarter of 1967, the “New Economists” claimed that we had enjoyed six years of uninterrupted economic growth. But the growth during 1961-1963 was not in any meaningful sense a result of national economic policies; it was instead quite similar to the upturn periods during the Eisenhower Administration, and no more satisfactory. It was this very fact that prompted the Kennedy Administration at long last to propose in 1963 the massive tax reductions which were really the first powerful step directed toward stimulating the economy. To be sure, this action taken in 1964 gave the economy a big boost for a while. As I have said many times, even this amount of money thrown into the streets and scrambled for would have done that. But as I warned before the Senate Finance Committee and elsewhere in 1964, the mistaken composition of the tax cuts was bound in time to revive and exacerbate the earlier types of imbalances described above. By 1965-1966, the rate of investment in producers'
facilities was advancing several times as rapidly as ultimate demand. Then, from first quarter 1966 to first quarter 1967, the GNP growth rate in real terms fell shockingly and dangerously to only 2.5 per cent, and was no higher from second quarter 1966 to second quarter 1967. In third quarter 1967, the growth outlook was far from clear; the proposal for a big tax increase had strong political overtones. I wonder whether Dr. Tobin is as enthusiastic now as he was in mid-1965 about the unalloyed wonders of the massive tax cuts.4

Dr. Tobin implies that we should not worry too much about this recurrent tendency toward private overinvestment relative to ultimate demand, since it will not have much effect in the long run on growth in our ability to produce. “[O]ver the decades,” he says, “fluctuations in the utilization of capacity will have a minor influence [upon growth] compared to the growth of capacity itself.”5 This, in my view, is a demonstrable error. As I said above, fluctuations in the utilization of capacity, reflected year by year in actual GNP performance, powerfully affect the rate of growth in capacity over the long run as well as the short run. Present capacity is tremendously below what it would be if a trend of adequate economic growth had been maintained since 1953 by avoidance of fluctuations. Even more important, it is palpably wrong to intimate that, if in 1970 capacity becomes as high as it would have been without any serious fluctuations from 1953 onward, the full use of this capacity in 1970 would find us as well off as if there had been no such fluctuations. Even in that unlikely eventuality, aggregate GNP for the period 1953-1970 would still have suffered immensely because of the fluctuations. The benefits of economic growth in the long run, in terms of rising living standards and other important criteria, depend vitally upon the aggregate of achievement over the years. Looking only at the end year in order to measure the growth rate is grossly misleading.6

The Public Sector; Respective Purposes of Spending and Taxation

The other half of Dr. Tobin’s 1960 thesis—that we should engineer shifts from private consumption to the public sector—was also far off the mark, and still is if reasserted now. I agree entirely, on grounds of national priorities, that a larger portion of GNP should be allocated

4. See TOBIN 41 (June 1965).
5. TOBIN 93 (May 1964).
6. For example, the average annual GNP growth rate during 1953-1966 was 3.5 per cent which was far too low. In consequence, although in 1966 we were not very far below reasonably full resource use, the aggregate deficiency in GNP, 1953-1966, was 720 billion dollars, measured in 1965 dollars.
to the public sector. But on both economic and social grounds, Dr. Tobin is wrong in urging to the extent that he does that the resource cost of achieving this objective should be met by repressing the growth of private consumption. His prescription here derives from his erroneous objective of lifting the long-term ratio of private investment to GNP.

I believe that this error stems not only from a misappraisal of the whole problem of maintaining equilibrium at full resource use, but also from an overestimating of the contribution which increased investment in public projects can make to the general well-being as against the need for increased private incomes and consumption. The thirty-odd million poor do indeed need more and better public facilities and services, but they need at least equally tremendous increases in their private incomes. The current war against poverty has over-emphasized public projects to improve the training, education and attitudes of the poor, and grossly underemphasized the need for massive public programs, especially at the federal level, to enlarge their private incomes through (a) guaranteed full employment for those who are or can be made employable, and (b) some sort of guaranteed income for others.

It must also be noted that, even while Dr. Tobin was on the Council of Economic Advisers, it began to develop policy recommendations, such as those for the massive tax reductions, which have sharply and progressively rejected his commitment to increasing the ratio of the public sector to GNP, and indeed have moved dangerously in the opposite direction. The extent to which Dr. Tobin acquiesced in this course raises interesting questions as to the responsibilities of a member of the Council of Economic Advisers. To give Dr. Tobin his due, he did say a few months after leaving the CEA:

a fiscal stimulus to the economy can be given by tax reduction as well as by increased expenditure. In fact, I believe that we should in general set government expenditures at levels consonant with national priorities in the use of full-employment output, and that we should then set taxes at levels which induce enough private spending to employ fully all the resources not purchased by government. 7

This fine statement that the great national priorities should be served first is exactly in line with my more extensive formulations of the same idea on numerous occasions, especially that federal spending should always be related to output at full employment rather than to

actual output. However, it is not entirely in line with Dr. Tobin's failure to raise a voice against the massive tax cuts of 1964, which ran so counter to these priority needs. Nor is it consistent with his expressed enthusiasm for how well the tax cuts have worked, and his approval of a "temporary prepackaged tax cut" to be used whenever the economy needs stimulation, despite the ever-growing neglect of the great national priorities which call for greatly increased federal spending.\textsuperscript{8} Here again, I find evidence of the recent tendency of liberal economists to run with the crowd among their friends in the government, instead of articulating vigorously and repeatedly their own convictions as to what the nation really needs.

I find it nothing less than shocking that so few liberal economists today, and almost none in the academic groves, are undertaking to educate either the general public or public officials about the enormous and enduring damage done, not only to our economic performance as narrowly defined, but also especially to the vindication of our prime purposes as a nation and a people, by the fiscal policies which the "New Economics" regards as the very hallmark of its historic achievement. Even if that policy had been fully successful on the purely economic front (which, as I have shown, is far from the case), it stimulated the economy by enlarging the distribution of the things we need least to have more of, at the expense of the things we need most. We got, for a while, several million more automobiles per year, when we needed several hundred thousand more new housing units annually for slum dwellers. Upon enactment of Medicare, we found that we did not have enough facilities and personnel to meet the increased demand for medical services, quite apart from the fact that about 40 per cent of our population are still unable to afford the modern medical services they need. The waters and airs remain polluted. The transportation mess continues. Most of the public schools in our great cities are in shambles. Higher educational opportunity remains unavailable to hundreds of thousands each year who have the ambition and the ability but lack the means. Fundamental resource development continues to be neglected. Expansion of social insurance has been totally inadequate, and the nationwide hodge-podge of so-called welfare payments remains confused, conflicting, bankrupt, and degrading.

And the end is not yet. The President's budget for fiscal 1968, as originally proposed, allocated only about 16 per cent of that budget,
and only about 2.7 per cent of GNP, to the eight programs in that budget which serve the great priorities of our domestic needs.

I cannot refrain from a word of high praise for my friend J. K. Galbraith. In 1958, when the *Affluent Society* appeared, he was not alone in stressing the unmet needs in the public sector, although he stated the case most eloquently. At that time he joined in the chorus of leaders in all walks of life who, in the aftermath of the first Sputnik in 1957, began to talk and write about our great national purposes. But Galbraith deserves even more credit for the extent to which he has courageously stood almost alone in more recent years. Who else among the New Frontiersmen since 1961 has challenged the tax reduction orgy, and continued to proclaim our imperative needs in the public sector? Some very distinguished economists, even after leaving the government have not been content to remain silent about policies inconsistent with everything they said and wrote before entering the government. Rather, they have actually continued to extol what they would have condemned if undertaken by a Republican administration.  

*Dr. Tobin's Precise Policy Views*

Further light is shed upon Dr. Tobin's views by what he had to say in 1960 as to the precise measures needed to implement his thesis. He proposed easier money, and with this I agree. He proposed lightening the tax burden on corporate investors through a variety of devices, especially depreciation allowances. He proposed increases in personal federal income taxes at all levels, with permission to deduct a portion of savings from taxable income to induce still more saving for private investment. These proposals (aside from the fact that the Council on which Dr. Tobin served countermarched toward immense tax reductions on all fronts) were founded upon the thesis that total savings were inadequate for investment purposes, which was based in turn on the erroneous assumption that a long-term increase in the ratio of investment to GNP was needed. The barrier to higher levels of investment, however, has not been any shortage in savings or other funds available to corporate investors, but rather their own appraisal of the inadequacy of ultimate demand for their products.

Coupled with the proposal for an increase in personal income taxes at all levels on a relatively non-progressive or even regressive basis, Dr.

9. Of course, Galbraith lampooned the importance of economic growth in *The Affluent Society*. But neither liberal nor conservative economists ever took him seriously on this point.

10. *Tobin 85-87 (July 1960).*
Tobin recommended increases in state and local taxes—property, sales, and income. Aside from the adverse impact of any such policy upon total economic performance, this proposal indicates a complete lack of responsiveness to the terrible distortion, from the point of view of any relevant social policies, in the incidence of the nationwide tax burden. Taking into account all forms of taxation at all levels, our national system of taxation is horribly regressive. The only effective partial counterbalance to the extremely regressive nature of state and local taxes has been the federal income tax. But even this tax has been made much less progressive by the actions taken in recent years. And the combination favored in 1967 by the Council of Economic Advisers—the restoration of the 7 per cent tax credit to corporate investors, and the proposal for a 10 per cent flat increase in taxes across the board—would accentuate the regressive nature of the entire tax structure, even with an exemption for families under $5,000.

It is interesting to note that, on the occasion of the celebration of the twentieth anniversary of the Employment Act, former CEA Chairman Walter W. Heller admitted that the previous tax reductions had been relatively unresponsive to the needs of those in the lower portions of the income structure, and that we should weigh tax reduction heavily in their favor when tax reduction again became feasible. The President shortly thereafter voiced the same sentiment in one of his messages to the Congress. But public policy is now moving in the opposite direction, and Dr. Heller and other "New Economists" are untypically silent.

Public Policy and Income Distribution

One of my most serious criticisms of Dr. Tobin's book is that it reflects the progressive neglect of the whole problem of income distribution which has been characteristic of the general trend in academic economics for twenty years or longer, and in which most of the nationally-acclaimed liberal economists have shared. There is a strange inconsistency between the valid proposition advanced by Dr. Tobin\(^\text{11}\) that resource allocation should be the main concern of the 1960's and the failure to recognize that it is primarily the distribution of income which shapes the allocation of resources. In ultimate terms of our traditions and aspirations, and immediate terms of a genuine dedication to a war against poverty, we cannot accept with complacency the fact that about 53 per cent of personal income goes to the highest income fifth in the United States, and only about 3 per cent to the

\(^{11}\) Tobin 78 (July 1960).
lowest fifth. Nor can any mature economic analysis lead to the conclusion that optimum economic growth and full employment can be restored endurably without drastic policies directed toward vast improvements in income distribution.

Yet Dr. Tobin says that "[r]edistribution of income and wealth by taxation and government transfer payments was in days gone by another rallying point for liberal political movements. The fire has gone out of this one too." He offers as a rationalization (though the degree of his own approbation is at this point somewhat ambiguous) this statement:

The Great Society is not a redistributive program. President Johnson does not raise the question of distributive justice, as between rich and poor or capital and labor . . . he proposes to solve the pressing problems of the Society . . . out of the vast annual increment in national product . . . This emphasis is on an ever-growing pie . . .

I have never been derelict in my emphasis upon the cardinal importance of an "ever-growing pie." But a pie will not bake as it should if it contains too much sugar and not enough flour, as evolving experience now so strikingly shows. Of course, Dr. Tobin has not hesitated to criticize the Goldwater proposal to reduce greatly the progressivity of federal income taxation. But I do not find any similar willingness to criticize the tax policies of the Administration which Dr. Tobin served, although these policies—while far better than those espoused by Goldwater—have swung far away from the progressive principle and the cause of distributive justice.

Until recent years, economists maintained—perhaps without justification, and certainly without much proof—that public policies did not have much influence in the long run upon the relative shares of income flowing to various groups. But no competent economist would dare to assert that proposition with respect to the years from 1961 onward. The richer are getting relatively richer, and the poor are getting relatively poorer, although the absolute number living in poverty has been reduced substantially if still too slowly. Many in between are being squeezed. Viewing the period 1961-1966 as a whole, there has been a tremendous shift in favor of profits as against wages, which explains in large part the recurrent imbalances between investment in

13. Tobin 42 (June 1965).
the expansion of producers' facilities and expansion of demand for ultimate products. These wayward results have been reinforced by almost the entire range of basic national economic policies—the composition of the tax reductions; the bias toward tax reduction rather than toward increased public spending; the Price-Wage Guideposts in their practical consequences; and the tight money policy and rising interest rates, which since 1952 have distributed more than 125 billion dollars in income from those lower down in the income structure who borrow, to those higher up in the income structure who lend directly or indirectly.

Assuredly, there has been no time since the 1920's when the powers of the federal government have been used so abundantly and effectively to redistribute national income upward. And during the 1920's, Mr. Mellon's achievements had relatively little impact upon the economy, because the entire scope of government was so small. While the Federal Reserve Board made some costly mistakes in those times, it was primarily the imbalances between profits and wages and between investment and consumption that brought on the Great Crash, for which the stockmarket debacle served only as the spark.

Nor can I agree with Dr. Tobin's apparent view that increases in personal income taxes under the progressive federal tax structure would necessarily tend to reduce aggregate employment and output. Entirely to the contrary, genuinely progressive increases in these taxes, which we now very much need (not in terms of current or proposed levels of federal outlay, but rather in terms of needed levels) can add greatly to our prospects for sustained optimum economic growth and full employment. This is patently true if the proceeds of these truly progressive tax increases are used to redirect goods and services primarily for the benefit of the sixty-odd million Americans now living in poverty or deprivation—benefits which in their very nature will add also to the safety, comfort, and enjoyments of the entire population, especially in the cities.

Does Growth in Productivity and Labor Force Determine Economic Growth, or Vice Versa?

Dr. Tobin also has some very interesting things to say about how much influence public policy can exert upon economic growth. With

15. TOBIN 128-29 (1956). Cf. 85-87 (July 1960), discussed at p. 1709 supra, advocating such tax increases as part of a program to accelerate growth.
some minor modifications, he appears to accept the prevailing view among economists:

the thrust of much recent theorizing and model building is that in the really long-run we have no choice [through public policy] about the growth rate. The long-run growth rates of GNP and aggregate consumption are exogenously determined by the growth of the labor force and the progress of technology [i.e. productivity].

I cannot too strongly dissent from this position. As earlier indicated, labor force growth, both short-run and long-run, is powerfully affected by employment opportunity and economic growth. We have suffered and are still suffering from a very significant amount of what I have called concealed unemployment—that is, people who because of scarcity of job opportunity are not participating in the civilian labor force, and therefore are not counted as unemployed. Furthermore, our experience in World War II demonstrates that the degree to which secondary workers enter the labor force is determined to a considerable extent by the actual rate of economic growth and actual employment opportunity. And a veritable host of public policies—social insurance policy, educational policy, etc.—can greatly affect the rate of growth in the civilian labor force, though the desirability of using such policies depends on the relative value placed on more output as against more leisure, earlier retirement, or other goals. Equally or more important, growth in productivity is not at all an exogenous factor in the rate of economic growth. The extent to which available economic resources are actually being used has a tremendous impact upon productivity, even apart from the influence of technological change. The failure to recognize this has been one of the most significant errors of the Council of Economic Advisers.

For instance, if a plant is operating at 75 per cent of capacity and retains 85 per cent of its labor force, the division of the 85 into the 75 per cent results in a low productivity figure. But this acknowledged inefficiency as a consequence of underutilization does not take into account the fact that since the productivity potential is continuing to expand there is a concealed lost productivity here very similar to concealed unemployment. My studies have shown the tendency of gains in productivity to accelerate over the years under conditions of reasonably full resource use, and to drop sharply in economic slowdowns. The experience of the past few years affords perfect illustration. Failure

to observe this persistently demonstrated phenomenon explains why the CEA has consistently underestimated the real rate of economic growth required to restore and sustain optimum resource use and optimum growth. It also explains the Council's many aberrations with respect to the appropriate relationship between changes in real wage rates and changes in productivity, which should be measured not in terms of actual productivity gains but in terms of gains in the productivity potential. Beyond this, the Council has been singularly unresponsive to the fact that actual gains in real wage rates have lagged seriously behind actual (not to speak of potential) gains in productivity, a subject to which I shall revert in discussing Dr. Tobin's views on inflation.

This failure by the CEA and many other economists to estimate realistically the full potential of the economy for growth is particularly damaging at a time when our heavy and rising international commitments, together with the social tensions and other evils resulting from neglect of the great domestic priorities, should make the very core of national economic policy the invocation of what I have often called the great nonsecret weapon of the American economy—its ability to expand production at a rapid rate. This is the first wartime period, at least during this century, when we have not clustered all other economic policies around the core purpose of accelerating economic expansion. What we did during World War II needs no recital. The result was that, despite allocation of almost half our output to fighting that war, we lifted living standards at home, improved income distribution, and brought the opportunity for industrial employment for the first time to those who had previously been excluded because of race, sex, and so-called lack of training and education. We did not listen to those who told us that inflation was a greater danger than Hitler or Tojo. During the Korean war, we again rejected the advice of those who urged us, for fear of inflation, to support the war only through reallocation of the existing product. Instead, we accepted a temporary increase in inflationary pressures as a small price to pay for using our great nonsecret weapon to the hilt. That decision yielded immense benefits, not only during that war, but for many years thereafter.

Yet today the CEA, far from even ruminating about calling forth this great nonsecret weapon, warmly embraces the prospect of a 4 per cent average annual growth rate in the years immediately ahead (though even this prospect may not be realized unless there are drastic changes in policies), and insists that an attempt to reduce the officially
calculated full-time unemployment rate much below 4 per cent might be dangerously inflationary. A full-time unemployment rate of close to 4 per cent means a true level of unemployment of 5½ per cent or higher, taking account of both the full-time equivalent of part-time employment and the concealed unemployment. That means a rate of unemployment among vulnerable groups so many times the nationwide average as to be fraught with social and political dangers of immense significance.

A 4 per cent economic growth rate does not merely fail to recognize what we could and should do. It fails even to provide for what we must do to attain the minimal objective of avoiding in the long run a substantial increase in idle manpower and other productive resources (concealed, if not overt). With an average annual growth rate in actual productivity of about 3½ per cent or higher during recent years (and a much higher growth rate in the productivity potential), and with the labor force, even without special encouragement, likely to grow at about 1½ per cent a year during the years immediately ahead, we need an annual growth rate of about 5 per cent a year merely to absorb the increments in productivity and in the civilian labor force after reasonably full resource use is restored. For a period of two years beginning in mid-1967, we need an average annual growth rate of well above 6 per cent to restore reasonably full resource use.

A few figures may help to convey the full significance of this disparity between what we need and what the CEA projects and even accepts. The difference between a 4 per cent and a 5 per cent real average annual growth rate in GNP over the next ten years means an average annual difference in real terms of about 50 billion dollars in GNP, and the difference between a 4 per cent and a 6 per cent growth rate means an average annual difference of about 100 billion dollars. The significance of these differences is indicated by the fact that an increase of about 11 billion dollars in the aggregate annual incomes of the more than 30 million poor would lift all of them out of the poverty cellar, or by the fact that federal outlays in the fiscal 1968 federal budget for the eight great domestic priority programs total only about 22 billion dollars. Yet we hear loud laments on all sides, with the CEA among the loudest lamenters, that in terms of our productive potentials, we "cannot afford" to undertake the essential.

**Econometric Models Versus Economic Reality**

Let me add one final point on the subject of economic growth. In my view Dr. Tobin attaches far too much importance to econometric
growth models. He says: "Thanks to theoretical advance in growth models . . . we have a better conceptual foundation for these tasks [economic growth etc.] than we did only a few years ago." ¹⁷ For reasons too technical to state here, some of the leading academic economists have gone simply wild about their econometric models, and this trend in itself is corrupting the main body of economic teaching, research, and honorific recognition, at least if one thinks of economics as a public-interest tool. Instead of relying so heavily on such models in the development of policy during Dr. Tobin's tenure and subsequently, the CEA should have paid much more attention to what had actually been happening to the economy during previous years, and to constructing interrelated and consistent quantitative economic goals for the future—the real intent of the Employment Act of 1946. If this less pretentious but far more meaningful approach had been followed, I believe that some of the policies actually put into effect would have been unthinkable.

The "Inflation" Scare and the Responsibility of Economists

During the era of the "New Economics," no less than earlier, exaggerated if not frenetic concern about the dangers of inflation has deflected attention away from more important problems and led to costly errors in economic policy. This behavior pattern has also been to a degree hypocritical; while shedding crocodile tears for the damage inflation does to those unable to protect themselves, some perpetrators of a number of the so-called anti-inflationary policies have in fact stuffed the fat and starved the lean.

In the volume under review, there are fleeting instances where Dr. Tobin indicates his awareness of all this. For example:

Perhaps price stability . . . can be justified as a means to achieving and sustaining high employment, production and consumption. Too often the means are accorded precedence over the end, and I am led to take up my pen to defend the basic objective of economic policy against its spurious rivals. ¹⁸

Again:

All good people dislike inflation, just as they oppose rainy weekends and traffic accidents. But, like many other evils, inflation is not an absolute and must be viewed in the perspective of com-

¹⁷. TOBIN 107 (May 1964).
¹⁸. TOBIN vii-viii (July 1965).
peting evils. A society can suffer much worse maladies than inflation . . . .19

And of course, during the Eisenhower years Dr. Tobin had no hesitancy about castigating the Federal Reserve Board for its preoccupation with misdirected and unsuccessful attempts to stop inflation at the cost of all else: “No one but Mr. Martin knows how much slack the Federal Reserve is willing to force upon the economy in the effort to stop inflation.”20 There have also been occasions outside his book when Dr. Tobin has spoken even more vigorously in this vein. But all these instances are dwarfed by the fact that the bulk of what Dr. Tobin has to say here seems to agree with and support the excessive preoccupation with and mismanagement of the issue of inflation which has continued unabated even after the advent of the “New Economics.” My own belief that “political economy” is a more fruitful concept than “economics” does not imply that our best economists, even when outside the government, should remain mute when those of their own political faith commit and sometimes compound the errors of the opposition.

Reviewer’s Position on Subject of Inflation

In order to make myself entirely clear, I need to set forth in some detail my own position on the subject of inflation before getting back to Dr. Tobin. In the first place, the United States economy has by all tests—historical, comparative, and functional—exhibited remarkable price stability. During the whole period from 1929 to 1966, excluding the entirely atypical conditions during the World War II era (1939-1948) and during one year of the Korean War (1950-1951), the average annual increase in consumer prices was only 0.1 per cent, and in industrial prices only 0.2 per cent, while wholesale prices actually declined at an average annual rate of 0.3 per cent. Even including the two atypical periods, the average annual increase in all prices over the past four decades has been very moderate by any reasonable standard. I shall discuss subsequently the significance of price trends since 1953.

Second, so-called “inflation” has not been a significant factor in our unfavorable balance of payments during recent years. Prices in the United States have been a great deal more stable than in other comparable countries. And because international price-trend differentials affect international trade, it is particularly significant that we have continued to enjoy a large favorable balance in our international trade

accounts. Indeed, this consistent surplus may indicate that we enjoy a larger share of worldwide markets than can be permanently maintained or than is consistent with that reasonable degree of equity in worldwide economic progress which will best serve our own interests in the long run. Our unfavorable balance of payments has developed in consequence of flows of investment capital from the United States to other countries, our defense outlays overseas, and our aid to the domestic economies and defense efforts of other countries. None of these causes relates significantly to actual price trends in the United States.

Third, and by far most important, there are no ultimate consequences of price trends per se, short of changes so rapid and drastic that they have no relevance whatsoever to the American scene since 1953. Prices are not an economic end, but rather one of many means by which resources are allocated in aid of the objectives of economic growth and its sensible utilization. Within meaningful limits, falling, stable, or rising general price levels may best promote these objectives. The truly important issue is the evolving pattern of relative prices and incomes, which determine the pattern of resource use. If all prices and incomes were to move upward or downward at the same percentage rates, nothing much would follow in consequence. The greatest economic debacle in the history of the country started after seven years of remarkable general price stability, except for falling farm prices—dramatic proof that a stable price level does not in itself prevent accrual of income maldistribution so severe as to knock the whole economy for a loop.

In view of the preoccupation of so many economists with “inflation” in recent years, it is astonishing that one is hard put to find a sober and comprehensive economic study evaluating, on an empirical basis, whether a moderately rising price level is more or less conducive to optimum economic growth and social justice than a stable or moderately falling price level. It is no answer to say that a stable price level is a good thing, everything else being equal. For everything else is never equal, and various trade-offs must be made between one objective and another. Dr. Tobin concedes as much when he says that the “choice is inevitably and properly a political one.”21 Even so, I do not agree with any implication that the “value” nature of the judgments excuses economists from responsibility for so much of the economic nonsense about “inflation” which has muddied the waters everywhere. As Keynes said, economists affect all judgments.

Fourth, and in reinforcement of the third point, economists with rare exceptions have propagated the dogma that the pressures toward price increases become more serious as the rate of economic growth accelerates and as we get closer to full employment. I say "dogma" because none of these economists has put it to a genuinely empirical test. I have done so in several studies, and have come up with results which many have ignored but none has attempted to challenge. From 1953 onward, there has been in general an inverse rather than a positive correlation between the rate of economic growth and proximity to full employment on the one hand, and price inflation on the other. For example, during 1955-1958, with the economy confronted first by almost absolute stagnation and then by an absolute recession, average annual increases in consumer, wholesale, and industrial prices were 2.5 per cent or higher. But during 1960-1966, with the economic growth rate in real terms averaging annually about 4.8 per cent, the average annual increase was only 1.6 per cent for consumer prices, 0.8 per cent for wholesale prices, and 0.6 per cent for industrial prices.

None of this is paradoxical; it can be readily explained. Just as an automobile operates less efficiently running at the excessive speed of 90 miles an hour or at the snail's pace of 24 miles an hour than when running at 50 miles an hour, so the United States economy operates less efficiently and generates more price inflation when expanding in real terms either at the World War II "forced" average annual rate of 9 per cent or at the 1953-1960 stagnation rate of 2.4 per cent, than when running closer to the optimum growth rate of about 5 per cent as it did during 1960-1966. The analogy is valid even at the slower rates because most of the upward price movements which have caused concern have been in the so-called administered-price areas, where price changes represent managerial decisions. In these areas, management tends to increase prices more rapidly during periods of inadequate sales than during periods of highly rewarding sales expansion, in an effort—sometimes successful, sometimes self-defeating—to compensate for the reduced volume by higher profits per unit of sales.

This thesis finds additional support in the acceleration of price increases in the administered areas during 1965-1967, when the economy was moving from a fairly high rate of growth toward a stagnation rate, and when fears of an impending recession were beginning to arise. The most disturbing increases in the nonadministered sectors of the economy during this recent period were in the prices of farm and food products and of medical services. The price increases at the farm level represented a totally inadequate movement toward a more
equitable share of the national income for farmers, and this was in short order succeeded by an unusually drastic decline in farm prices. The increase in the cost of food at the retail level was for a time due in part to the rising farm prices, but it has also been closely associated with the problem of administered prices. The increases in the cost of medical care reflected, among other things, the shocking neglect of national efforts to develop an adequate and properly distributed medical service. The government's anti-inflationary policies were not at all directed at the rising cost of medical care. Indeed, far from stemming the increase, they actually contributed to it in the long run by starving public outlays for critically needed medical facilities and personnel, especially in the public sector.

Yet monetary policy since 1952 has persisted, with only minor undulations, in restraining the rate of growth in the money supply, restricting credit, and pushing interest rates upward—all on the theory that a reduced rate of economic expansion would help to combat "inflation." The actual consequences have been to repress needed economic growth, limit the reduction of unemployment, and aggravate the neglect of the great domestic priorities (including social justice to the poor). Tighter credit and rising interest rates have curtailed desirable activities and hurt the vulnerable; they have done little to check the parts of the economy which were developing relatively too fast, and they have actually added to the incomes of those at the top. While the Administration since 1961, and the economists serving it inside and outside the government, have sometimes muttered their disapproval of Federal Reserve policies, the Reports of the CEA during this period have in the main defended these policies and have at no time issued any substantial challenge to them. Nor has Dr. Tobin—since 1961.

Prior to 1967, the "New Economics" had not made substantial use of fiscal policy to fight "inflation." But the January 1967 Report of the Council of Economic Advisers, in supporting the proposal for a 6 per cent across-the-board tax increase (as distinguished from progressive tax increases coupled with needed increases in domestic public spending), demonstrated the complete adherence of the "New Economics" to the dogma of a necessary positive correlation between (a) the rate of economic growth and proximity to full employment and (b) the danger of price increases. And quite apart from the price issue, early 1967 was a preposterous time for the CEA to be seeking to repress the actual economic growth rate, or to be espousing an economic growth rate of only 4 per cent and a full-time unemployment rate of close to 4
per cent. The shift to espousal of a 10 per cent across-the-board tax increase later in 1967 doubled the error in spades.

But some "New Economists" of very high repute, such as Dr. Heller, have argued that the proposed tax increase was proper on "moral" grounds in order to convince the American people of the seriousness of the international situation, and on "political" grounds in view of the prospective size of the federal deficit. I can see nothing particularly moral about persuading the American people to adopt a policy which would sacrifice a part of the economic performance that we need on the altar of fiscal self-flagellation. Why not a day of fasting each week to make us aware of the international situation, although we have an abundant food supply? The political argument for a tax increase merely to reduce the prospective size of the federal deficit (which may not in actuality be reduced because the tax increase is the wrong medicine even for that) represents a complete about-face on the part of the "New Economics," which previously had claimed that it had both learned and taught others the lesson that the federal budget should be shaped in terms of the needs of the national economy.

Still another reason advanced for the proposal to increase taxes in order to fight "inflation" in the face of a stagnant economy is that even a stagnant economy may be endangered by "cost-push" or "income" inflation, resulting from excessive wage settlements which lead to price increases. Before getting into Dr. Tobin's views on this subject, reference should be made to his statement that neither fiscal policy nor monetary policy is an "effective antidote" to "income" inflation. For irrespective of the validity of that view, the really important point to be made is not that neither of these two policies is an "effective antidote" to "income" inflation in consequence of excessive wage settlements; it is rather that excessive wage settlements are an imaginary danger which has haunted Dr. Tobin and the "New Economics" since 1961. The result has been an obsessive concern with preventing excessive wage increases which has contributed further to the regressive tendencies in national economic policy.

The Price-Wage Guideposts

Indeed, the best evidence of the misdirected thinking of the "New Economics" with respect to the "income" inflation problem has been the Price-Wage Guideposts. For quite apart from the actual economic

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23. For evidence of Dr. Tobin's own concern about this alleged cause of inflation, see Tobin 119 (1965), 124 (Aug. 1951) and, more generally, 128-33 (1950).
realities with which they had to deal, these Guideposts committed the elementary error of looking upon wages only as a business cost, and not also as a factor in consumer incomes. They sought to prevent wage increases which might impose excessive costs upon business and thus lead to price increases, but they evidenced no concern about the inadequacy of wage increases from the viewpoint of balanced expansion of consumer income. Regardless of which of the two problems has in fact been the more important, the failure to look at both resulted in attempts to influence wage trends without any comparable effort to influence price trends, and without the establishment of any standard whatsoever for appropriate levels of profits. Those attempts, which ignored both the vital relationships between wages and profits and the fact that prices are mainly a factor in determining the relative trends in real profits and real wages as they bear upon the balance between consumption and investment, exhibited an almost inexplicably naive concept of the whole economic problem.

Further, this one-sided perspective was totally unresponsive to the realities of the economic situation either before or after 1961. For the core problem, as has been shown, was the constant or at least highly repetitive tendency of profits and investment to be far too high in proportion to the ultimate demand in which wages are so important a factor.

The details of the Guideposts with respect to wages not only misinterpreted the problem; they actually aggravated it by using the nationwide average gain in productivity as a ceiling but not a floor. They attempted to hold down to the level of the average nationwide productivity gain the wage increases in the industries whose productivity gains were higher than that average, but did nothing to bring up to that average the wage settlements in industries whose productivity gains were below the average. This curiously inconsistent policy assured that the nationwide average of wage-rate gains would lag far behind average productivity gains. It thus in effect assured the defeat of the very principle on which the Guideposts allegedly rested: that nationwide wage-rate gains should be kept roughly in line with nationwide productivity gains. That this imbalance has in fact been a salient feature of economic development during 1961-1966 as a whole has belatedly become so commonly recognized that it would be superfluous to document it with many facts. Suffice it to say that, during 1961-1966, output per man-hour in the total private non-farm economy increased at an average annual rate of 3.1 per cent, while the compar-
able rate of increase in real wage rates per man-hour was only 2.7 per cent.

On social and equitable grounds, there would be much to be said for a policy which held wage-rate gains in the highest productivity industries below the nationwide average of productivity gains, if it were accompanied by two other sets of policies: (1) policies which put some real pressure upon the high-productivity industries to reduce their prices, and which imposed enough taxes upon them to prevent exorbitant profits, which are both an incitement to labor and a spur to excessive investment, and (2) policies which deliberately used the resources of the government to supplement the incomes of lowly-paid workers in low-productivity industries so that their incomes might at least keep pace with the nationwide average of productivity gains. But neither of these two sets of policies has been even faintly attempted. Instead, the high-productivity high-profit industries have been plied with all sorts of additional tax bounties and concessions, even while the Council of Economic Advisers has rejected as "inflationary" an increase in the minimum wage sufficient to enable the poorly-paid workers to make progress at a rate only somewhat below that of the nationwide productivity gains.

Although the volume under review has little if anything to say about the Guideposts, I have found no evidence in other sources that Dr. Tobin has questioned them, except possibly on grounds of efficacy. He has certainly joined in the mistaken economic analysis they reflect.

Dr. Tobin's Proposals for Dealing with Inflationary Threats

Dr. Tobin's own suggestions for dealing with the "income" inflation threat, which he appears to deem as real a problem as does the CEA, do not include direct price-wage controls. I agree completely, short of a much more acute defense emergency in economic terms than we are now experiencing. Moreover, to give the government power to fix prices and wages would do more harm than good if the underlying economic analysis remains the same as that exemplified by the "New Economics" in recent years.

In the fight against "inflation," Dr. Tobin does favor aggressive and aggregative monetary controls. I cannot entirely reconcile this position with his belief that monetary controls are ineffective in dealing with "income" inflation, in view of the clear evidence in the volume under review when read as a whole that this is the kind of inflation

which he most fears. More important, I have frequently challenged the efficacy of aggregative fiscal or monetary attempts to stimulate or restrain the economy in the absence of more refined analysis as to which parts of the economy need to be stimulated and which parts restrained.

**Toward a More Mature National Economic Policy**

The shortcomings of the "New Economics" really boil down to this: It has tended toward copybook-maxim application of general theories, without constructing a satisfactory picture of the economy in operation and the goals to be sought. These defects arise, in the final analysis, from failure to observe the real mandate of the Employment Act of 1946.

What, then, ought to be done for the future? First of all, a careful quantification should be made of the operation of the economy in the recent past, on both the product and income sides. The figures thus obtained should then be analyzed to determine what imbalances contributed to the unsatisfactory economic performance, and the alternative policies which would have worked better. Benefiting by this resort to experience, the CEA should construct a long-range and equally detailed quantification of goals for the future, taking into account the inseparable objectives of optimum economic growth and attention to the priorities of our national needs. It should then construct and coordinate a complete and comprehensive set of national economic policies for attaining these goals, including as a minimum fiscal policy, monetary policy, social security policy, housing policy, farm policy, and some of the regulatory policies.

If the powerhouse of national public policies were thus put in order, I believe that government economic programs would work fairly well without much public tampering with managerial price decisions or collective bargaining. And because I think first things should be put first, I would like to see the government make additional attempts to sharpen its own tools through improved analysis. After all, if the Price-Wage Guideposts had been accepted in full instead of being ultimately rejected, the economic results would have been even worse than they were, because the economics of the Guideposts was so meretricious.

Nonetheless, a reconstruction of public economic policies would leave room for potentially useful further efforts to develop guidelines for voluntary price and wage adjustments, derived from the same interrelated goals as those prescribed above for public economic policies. But there must be institutional devices quite different from the late Guideposts. The new guidelines should be entirely voluntary, because
it does not promote a viable or healthy relationship between government and private enterprise for the government to decide on an ambiguous and ad hoc basis whether a publicly declared policy is to be pressed as quasi-law or entirely ignored. In public administration, there is room both for the voluntary and the imperative; there is not much room for a nebulous hybrid of the two.

More important, the voluntary guidelines I suggest as an integral part of the economic analysis entering into the work of the CEA and the Economic Reports should allow consultation with functioning economic groups at the formulation stage, sufficient to give them a sense of participation and enlarge their understanding. This purpose is not served by so-called Labor-Management Conferences conducted under the aegis of the White House, which merely provide each side another chance to tell the other how wrong it is, and result at most in rather sterile joint pronouncements which avoid the real issues. Labor-Management Conferences might provide one instrumentality for what I have set forth above, provided that the CEA took the leadership in providing these conferences with long-range perspectives developed in concrete form. But to do this, the CEA must change its entire concept of its own functions. For it would be silly to think that the CEA could bring to those outside the government what it has not yet brought even to those inside.

Even a casual glance at the Reports of the President and the Reports of the CEA under the Employment Act would reveal that nothing approximating what I have often suggested has yet been attempted. Measured against these requirements for effective planning under freedom, which are imposed by our own domestic situation and by the worldwide competition confronting us, the "New Economics" is not new enough. In truth, it is new only when measured against the economics of the 1920's and early 1930's.

**Gold and the Balance of Payments**

Dr. Tobin's discussion of the international monetary system leaves almost nothing for me to criticize in what he states affirmatively, and much for me to applaud. The discussion is expert, thoughtful, and highly suggestive. It makes constructive suggestions for improvements in the international monetary system, and with these I am generally in agreement. The subject, however, is perhaps too technical for further discussion here.

But I am considerably discouraged that Dr. Tobin has not said a good many things that need to be said, and said particularly by those
in his position. He does say—three years after leaving the CEA—in discussing the dollar crisis and related matters:

[If the financial ship has weathered it, it has done so only by jettisoning much of the valuable cargo it was supposed to deliver. Currency parities have been maintained, but full employment has not been. The economic growth of half the advanced non-Communist world has been hobbled. . . .]

However, just about the time he was appointed to the CEA, he made the following statement in a quite different vein, which was a sad omen of things to come: “To achieve it [a solution to the dollar crisis through international monetary agreements and mechanisms] is the first economic task of the new [Kennedy] Administration. Otherwise we shall not be free . . . to embark on new domestic programs.”

This prophecy was not entirely accurate, because of course some new domestic programs were embarked upon, even though the needed international solution was persistently avoided. But the emphasis upon achieving this solution as the top priority served as a warning that the “New Economics” was prepared to exaggerate the impact of the balance of payments problem quite as irrationally as it was prepared to exaggerate the “inflation” threat, and thus to impale us upon a new cross of gold.

In fact, while the balance of payments problem has still not been effectively attacked, the “New Economists” did use it to justify policies which hobbled and distorted the domestic economy. One of the main arguments repeatedly advanced in support of the new fiscal policies was that, regardless of domestic needs, this extraordinary stimulus to investment in producers’ facilities was essential to improve our competitive position in international trade and thereby help our balance of payments problem. As I have already indicated, the balance of payments problem is not attributable to any weakness in our trading position, and excessive emphasis upon its importance has served rather to engineer dangerous cutbacks in our economic aid to the underdeveloped countries.

I believe that the message which should have been impressed upon the people and reflected in public policy is something along these lines: In our own self-interest, and in support of some essential aspects of our avowed international policies, the flow of American capital to underdeveloped nations should expand so rapidly as to result in a
fairly consistent and large increase in our unfavorable balance of payments for as far into the future as we can see. It is impossible for all nations to improve their balance of payments situation at the same time. Practically all of the underdeveloped countries, and many of those which are highly developed urgently need to avoid a so-called worsening of their balance of payments situation. We do not. We are verily a great domestic empire, and far less dependent than others upon the state of our international payments account. I predict that, within a decade or so, preoccupation with this problem will seem as anachronistic as the views of those who today are still as fearful of federal deficit spending as most people were a generation ago.

In any event, the parable of the tail swinging the elephant does not approach in absurdity the spectacle of our attempts—unsuccessful at that—to improve our balance of payments position by a few billion dollars at most, at the cost of scores of billions of dollars annually in our national product. The real problem is to cut as rapidly as we can the connection between the balance of payments problem and its settlement in terms of gold. The degree of our commitment to this yellow metal is both slavish and superstitious. It is also hopeless. Since the gold supply of the world is increasing at only about one per cent a year, while the monetary systems underlying both domestic economies and international exchange must expand sufficiently to support fundamental economic expansion at annual rates of 5 per cent and much higher (depending upon the country), any substantial connection between gold and monetary systems becomes progressively crippling. Moreover, if we could corner all the gold in the world, it would still do us no good in the long run, because other countries would take steps to avoid being ruined by our monopoly. We would do likewise if others held more gold than would permit us to honor the gold myth.

I cannot help but believe that Dr. Tobin really feels the same way. I wish that he would say so, loud and clear. He should have said so, loud and clear, even when he was on the Council of Economic Advisers, and when it became so unmistakably plain that we are on the gold track instead of the right track.

The Role of the CEA

Dr. Tobin's discussion of "academic economics in Washington" is disappointing. It does not really concentrate upon what the academicians in Washington should do, especially when on the CEA, but instead attempts to argue how fortunate it is for everybody that (since 1953 at least) the members of the Council of Economic Advisers have been recruited entirely from the academic groves.
It is really not the fact that academic economics, in its recent or current manifestations, is a uniquely desirable form of training for policy advisers in the top ranks of public service. To recruit the members of the CEA entirely from this one source is comparable to choosing the Secretary of State by a poll of the teachers of international affairs at our leading universities, or to recruiting members of the Joint Chiefs of Staff solely from among teachers at our military academies. Even in economics, there is merit in Clemenceau's aphorism that war is too important to be left entirely to the generals.

The academic monopoly is even less desirable when, as has happened in fact if not in form, all members of the Council of Economic Advisers since 1953 (except the first Chairman under Eisenhower and the first Chairman under Kennedy, who could not be so selected) have been chosen by their friends and admirers who got to the CEA before them, rather than by the President of the United States. This kind of progressive inbreeding is, on many scores, not ideal. One specific consequence has been a partial stifling of objective evaluation of the CEA by former CEA members and their guild.

I agree only to a limited extent with Dr. Tobin's statement that resignation is the ultimate protection against the danger that the Economic Advisers may be used to justify and embellish policy decisions which they have had no part in making. Some such resignations have indeed been in order, and there have been too few of them. But the much larger difficulty is that the Economic Advisers have participated too much in the making of decisions contrary to their own beliefs, and contrary to what they should have been advising.

It has by now become axiomatic among the "New Economists" that there was no other "political" choice than the policies which I have criticized. To this there are three answers. The first is that, while a President must make the ultimate decisions which are in a sense political in nature, he cannot develop a satisfactory calculus among competing considerations unless the economists refrain from shaping their advice too much to what they consider the political factors to be, instead of steadfastly laying on the line what they really think needs to be done. The tendency to follow the former course is perhaps accentuated when the Council of Economic Advisers is composed entirely of academic economists, who are prone to think that they must lean over backwards when they enter "practical" affairs.

The second answer is that, based upon my own considerable experience, I feel that some of the decisions made by Presidents in recent years would have been quite different if the Economic Advisers had advised them differently. Presidents are not economics experts and, in large matters, they tend generally to do what they think is best for the country, and to rely considerably upon what their experts say.

And the third answer is that there is a wide gap between what it is easiest to do politically and what it is feasible to do politically with sufficient effort and perhaps a willingness to accept a considerable amount of conflict. Progress in a democracy often necessitates considerable conflict. One of the great problems of our times is to make sure that the ceiling of so-called political feasibility is not so far below the floor of what we may need to do to survive and prosper that we run into avoidable disasters.

While Dr. Tobin's volume deals with specific issues of economic policy, Dr. Heilbroner's is much more generalized. To use the term he originated for one of his earlier books, he writes as a "worldly philosopher." Yet there is a much closer connection between the two books than might appear at first glance. With rare exceptions, the basic analysis of the "New Economics" is the inarticulate major premise of Dr. Heilbroner's book. In the main, therefore, it would be repetitive for me to direct against Dr. Heilbroner some of the criticisms I have aimed at Dr. Tobin. It may be fair to make the point, however, that some of the excessive optimism about the future which I think may be charged against Dr. Heilbroner may be due in part to his assumption that the "New Economics" has carried us further along the road of progress than it actually has.

Entirely apart from what I have just said, I am rather disappointed in this new book by Dr. Heilbroner. "Popular" books serve a unique and essential purpose. But in my view, the medium of expression does not relieve the author of responsibility to delve a bit more deeply into those problems which he himself chooses to identify but skims over too lightly. In this connection, my disappointment arises not from any inclination on my part to tell any author what he should put in his book, but rather from my awareness of what Dr. Heilbroner can put into a book. Some of his earlier volumes, such as The Worldly Philosophers and A Primer on Government Spending (with Peter L. Bernstein), were splendid contributions to the popularization of economic knowledge and the enlargement of economic understanding. I do not use the word "popular" in any deprecatory sense. Dr. Heilbroner has frequently—in fact generally—stood on firmer ground, reached better judgments, and
displayed a more elevated sense of values and priorities, than many other economic writers who have hidden their essential vulnerability in a cloud of technicalities and pretenses. The new book does not satisfy me because it is not Dr. Heilbroner at even near his best. And I feel that this is a waste, because we all need many more books from him that are akin to his best.

The first of two long essays in the new book purports to deal with capitalism in America as it is. Facts are presented which demonstrate that giant corporations control an immense portion of the United States economy, but that the trend toward concentration has been slowing down. This demonstration is correct. But I think Dr. Heilbroner makes too much of this point. An increase in the speed of an automobile from 10 to 70 miles an hour exceeds by this test a further increase from 70 miles an hour to 110, but the latter development may pose much more serious problems than the former. Besides, the really interesting and important issues are the business practices which this giantism engenders, and the institutional problem of how big business and big government may reinforce or counterbalance one another in the actual implementation of economic policies.

The author then turns his attention to a discussion of the attitudes and outlooks of big businessmen, and to an appraisal of trends in their influence upon the economy and economic policy at large. He cites some interesting statistics indicating that the overlapping of ownership and management is relatively slight; that management is not drawn predominantly from any one class; and that the extremely wealthy men who hold large blocks of shares in particular corporations probably exert a good deal of pressure with respect to the original selection of top management, but not much with respect to managerial decisions thereafter.

Then he presents a series of lectures by businessmen to show that, taking their own phraseology at its face value, they are becoming increasingly aware of the larger world and of their social responsibilities. He indicates a healthy sense of skepticism as to whether these assertions are much more than an attempt at good public relations. But I think it would have been much more helpful to explore what big businessmen have to say on specific issues of economic policy, both private and

public. The evidence that they had so little to say on those issues in the series of lectures cited is in itself revealing.

Discussing trends in the effective power of giant businesses, Dr. Heilbroner reaches the conclusion that they no longer overpower labor. This is undoubtedly true. But comparisons of the current situation with the former helplessness and exploitation of labor tend to support the currently common view that true equality has been attained. It may even imply to many readers (although it is not stated) that the pendulum has swung decisively in labor's favor.

The truth is not to be found in such generalities. A closer approximation to the truth may be obtained primarily by examining the significance of the portion of the work force which is still unorganized, and equally by evaluating relative trends in profits and wages during recent years and their impact upon our entire economic performance. My examination of these questions in reviewing Dr. Tobin's work makes my own position clear. And again I feel bound to state my regret that economists as liberal, perceptive, and influential as Doctors Heilbroner and Tobin are not directing more public attention to this point.

Dr. Heilbroner also concludes that giant business is coming to exercise far less power over small business, and attributes the decline of small business to the market place rather than to big business. I do not believe that this conclusion is really supported by comparing the predatory policies of the first Rockefeller with the policies of today's tycoons. It would take much more evidence and analysis than Dr. Heilbroner has brought forth to convince me that there is not much causal connection between the practices of the giants and the demise of small business. It might be useful, in this connection, to take a look at the way giant industry typically treats its small business suppliers of components. In any case, cause and effect analysis is always tricky, and I would find more significant an evaluation of the economic and social significance of the continuing growth of the giants, albeit at a slower pace, and of the continuing decline of small business. (I do not mean by this to take a position for or against either of these trends.)

The author concludes that the power of giant business over the consumer is excessive, and cites as evidence the fact that prices are still too high. My first comment would be this: Insofar as the statement that prices are too high means that resources are being misallocated, and insofar as the allocation would be quite different if the relative power of big business and labor were different, I cannot entirely square Dr. Heilbroner's conclusion regarding the business-labor relationship with his conclusion regarding the business-consumer relationship. Besides,
all workers are consumers, and collective bargaining is directed toward improving their living standards as consumers.

More important still, Dr. Heilbroner suggests that the only effective weapon against redressing the corporate-consumer relationship is improved competition. But he does not tell us how this could or should be brought about, and he ignores the core problem of the role of public policies in influencing pricing practices. Quite aside from controls and voluntary guidelines, fiscal policy has a very important effect on pricing. Industries can hardly be expected to show price restraint when they are given enormous tax concessions based upon their assertion that they need more profits after taxes. Conversely, higher taxes can be used to reduce the marginal value of price increases.

The essay on capitalism concludes with an argument that the power of big business over legislation is waning, and that the true power of the military-industrial complex resides in government, not business. I submit that proof of this thesis would require much more subtle and penetrating analysis than is offered. The author seems to rest his case on the relative decline in the number of big businessmen in the public service vis-à-vis scientists and other academicians. I take a dim view of the idea that businessmen in the public service are the principal source of big business influence on public policy; they, like academics, may tend to lean over backwards to make themselves politically respectable. The real source lies rather in the extent to which contacts with and reliance upon private business advice determine public economic policies.

And one may also wonder how much the increasing subsidization of the universities by big business and the part-time private consultation activities of university professors affect the actions if not the thoughts of those who are assumed to be entirely objective. I do not find as much solace as Dr. Heilbroner does in the immense contribution which big business is pouring into the educational stream. It has always struck me as ironic that so many are concerned lest federal aid to education influence the teaching process, and so few about the contributions to education by private foundations whose management and control are not quite so divorced from the business community as many suppose.

The second portion of Dr. Heilbroner's book deals with "the limits of American capitalism." The main discussion begins with a five-page demonstration of the proposition that capitalists resist change because

31. Heilbroner 70-75.
they enjoy privileges. This seems to me an outstanding example of taking too long to say too little. It could all be put into one sentence— that capitalists resist change because they are doing so well without change.

It is then argued that capitalism does not bear much responsibility for the amount of American poverty, because by and large the poor are not industrial workers, and because the distribution of the 70 billion dollars of annual corporate profits (as of the mid-1960's) among the whole work force would lift the living standards of the poorest very greatly, but would not have much relative effect upon the living standards of others. This latter argument is not very much to the point, because there is no serious proposal under discussion to reallocate income to the entire work force, including workers earning $12,000 a year. It has been competently estimated that an increase of about 11 billion dollars in the annual incomes of the poor would lift all of them out of the poverty cellar. Moreover, as I have shown elsewhere, 60 per cent of all of the poverty in the United States is due to full-time or part-time unemployment and to substandard wages of those employed. Thus, with a genuine full-employment policy, those who cannot be employed could be lifted out of the poverty cellar at a cost of about 6 billion dollars a year.

Dr. Heilbroner himself accepts the 11-billion-dollar-a-year figure which I have cited. In the discussion which follows, he expresses the view that the opposition of the capitalist elite to a redistributational program of even this modest size, and the high cost of defense, will probably delay the extirpation of poverty for another three or four decades. I think that this forecast is far too dismal, and that poverty could be virtually eliminated within ten years by utilizing a very tiny fraction of what I have called the "economic growth dividend," and indeed without increasing the ratio of the federal budget to GNP.

One of the most interesting and useful parts of Dr. Heilbroner's book is the table which shows how regressive actual tax rates are, when compared with the scheduled rates. Since the trend in federal taxation is toward increasing regressivity, I feel that much more emphasis should be placed upon the vital importance of making the federal income tax structure more progressive. I think that Dr. Heilbroner grossly under-

32. Heilbroner 76-80.
33. Heilbroner 81.
34. Heilbroner 80-84.
35. See A "Freedom Budget" FOR ALL AMERICANS (1966), published by the A. Philip Randolph Institute, of which I was the principal author.
36. Heilbroner 86.
states the economic importance of improved income distribution when he says:

The maldistribution of income and the social problems that spring from it can no longer be said to constitute an issue that threatens the viability—although it may seriously jeopardize the social peace—of capitalism. 37

I have earlier stated my conclusion that greatly improved income distribution is essential even to sustained optimum economic growth and the avoidance of considerable cyclical disturbances.

Dr. Heilbroner proceeds to an interesting and useful discussion of remedies for cyclical instability, which he does regard as a genuine threat to capitalism, even though he does not recognize fully the connection between this instability and income maldistribution. He is moderately optimistic that the maintenance of aggregate demand through modern fiscal policy can deal substantially with this problem, and he says that the real question is whether we will go beyond the issue of stabilization to the issue of allocating a sufficient portion of our burgeoning resources to the social well-being. For reasons which I have stated earlier, I believe that this allocation and the solution of the economic problem when more narrowly defined are really one and the same thing. Dr. Heilbroner is not too optimistic about the prospects for improved treatment of the allocation problem through more emphasis upon planning, though he sees the need for greater efforts in this direction. But his discussion of this question trails off rather inconclusively; it would have been preferable, in my view, to specify and evaluate some of the types of limited planning which do not seem to me unattainable, even within the context of Dr. Heilbroner’s basic assumptions. 38

The final pages strike the optimistic note that economic growth, rising general standards of living, increased stress upon the types of work which are valuable for their own sakes rather than their material yield, and, above all, the progress of science and its application to technology, will enable us by evolution rather than by revolution to make the decades ahead better than those which have passed. 39 Fundamentally, I share this optimism. But I am not sure how much good it does to state it without saying much more, for it may easily foster the illusion of the inevitability of progress. I feel that our current problems on the

37. Heilbroner 88.
38. See A “Freedom Budget,” supra note 35.
39. Heilbroner 110-34.
domestic scene, not to speak of overseas, should generate a sense of urgency and programmatic particularity far beyond what this book has to offer. And so I close with what I said at the start—that Dr. Heilbroner has been entitled to choose his own content, but that I fervently hope that this gifted and morally-aware author will turn in his next work to a more insistent call to action.40


The purpose of this book, as stated by its author, is twofold: first, to survey the major issues raised by the United Nations Conference for Trade and Development (UNCTAD) for United States policy toward the less developed countries; second, to explore the various alternatives for American trade and development assistance policy for the benefit of government officials, academic experts, and concerned members of the public.¹ Its scope is therefore quite broad. It deals with all the major external economic factors affecting development: foreign aid; commodity agreements; compensatory financing for shortfalls in exchange earnings from exports of primary commodities, both mineral and agricultural; tariff preferences for the manufactured and semi-manufactured products of less developed countries; protectionism in developed countries; and international monetary reform. Detailed consideration is also given to a number of internal aspects of development.

At a time when the obstacles to economic development of the underdeveloped countries are “innumerable and elusive,”² it is not surprising that all kinds of prescriptions for improvement should be advanced. Nor is it astonishing that less developed countries and their spokes-


men should be abstemious in advocating those measures which require domestic self-help in the form of often painful economic and social changes of a deep-seated nature, and most energetic in calling for external assistance. UNCTAD, which in effect represents the less developed countries, has been vociferous about the need for external assistance, particularly in the form of trade measures, but barely vocal about self-help; even while recognizing its importance, Raul Prebisch, as head of UNCTAD, has felt constrained to understatement the need for internal reform.

Early in his book, however, Johnson puts economic development in its proper perspective. The development problem is one of converting a "traditional" society, based largely on subsistence or near-subsistence agriculture and on the export of a few primary commodities, into a "modern" society. Economic development requires the transformation of both a society and its economy. A pastoral, caste-ridden, oligarchically-organized society cannot be industrialized; industrialization requires not only a rational approach to the production process—i.e., organizing production in business enterprises characterized by specialization and division of labor—but also a skilled labor force, competent professional managers, and a competitive environment to assure the efficient allocation of resources. Radical changes are often needed in land tenure systems as well, and the distribution of income must be shaped to create a middle class motivated to improve by work and education its own and its children's economic condition.

Having identified the primacy of internal reform as the sine qua non for economic development, Johnson did not regard it as part of his task to consider how such reforms might be brought about. This task of political and economic analysis of the means of achieving the objective, although clearly acknowledged to be as important as an appreciation of the proper goals, was left to others. His undertaking, large enough in itself, was limited to a consideration of the best methods of extending external assistance to development.

In general, Johnson advocates those measures of external assistance which maximize the allocation of resources according to comparative advantages in the production and distribution of goods and services: free trade and the dismantling of protectionist measures on a non-discriminatory basis, and straight foreign aid in much larger amounts.

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4. H. JOHNSON, supra note 1, at 44.
and on better terms. He urges that aid be extended in the form of grants rather than loans, and he deplores conditions such as "tying" assistance to procurement in the lending or granting country or requiring that given proportions of goods procured with the proceeds be shipped in bottoms of the donor nation. These are not radical prescriptions; they represent the freer trade and aid principles which most economists, as well as many governments, have urged, with varying degrees of success since the Second World War.

However, Johnson is pessimistic about the prospects for enactment of a larger program both by an increasingly recalcitrant Congress, which is preoccupied with the war in Vietnam and the balance of payments situation, and by other developed countries, and he thinks the chances for lessened protectionism in the developed countries are poor. This fear of very limited future progress along the right road, more than infatuation with the merits of the alternatives, has led him to examine seriously, as a possible "second best," proposals such as those urged byUNCTAD concerning commodity agreements and tariff preferences. Poor though he acknowledges them to be, he thinks these measures may be better than "nothing," since they can at least result in some resource-transfers to some less developed countries.

Johnson's own criticisms of the economic arguments for tariff preferences leave little to be said; his more tender treatment of commodity agreements leaves somewhat more. As he himself recognizes but underemphasizes, the current rationale for commodity agreements is vastly different from the Havana Charter idea of securing "reasonable stability of prices about the current long-period trend" in order to protect small producers and wage-earners when normal market forces cannot be relied upon to do so. That conception was soon modified to promote "stabilization," not solely for the benefit of producers and workers but also to ensure regularity in the exchange earnings of the primary-product country itself. This change was tacitly accepted in the 1950's by consuming and producing countries alike. Now UNCTAD is urging a second change in purpose—this one from price stabilization to price augmentation. It wants to use commodity agreements as a form of aid from the richer countries to secure higher levels of export earnings for the poorer primary-producing countries. Commodity agreements are envisioned as the international counterpart of familiar

5. Rowe, PRIMARY COMMODITIES IN INTERNATIONAL TRADE 157 (1965).
domestic agricultural interventions such as price supports financed through artificially higher consumer prices—which means that ultimate consumers least able to pay would bear the greatest burden of supporting international welfare measures.

The difficulties with commodity agreements thus conceived are far too serious to expect that they will be accepted at all as a general policy, much less as a "second best." As Rowe has pointed out, commodity agreements on this model not only are an inefficient means of giving aid, which they do in a haphazard manner with no relationship to real development needs, but could well be "disastrous . . . to the growth of the world’s wealth at the maximum rate." If prices are not related to costs of production, resources are being wasted somewhere; if the supply of primary products is restricted below what the world should have, the whole economic system becomes twisted and warped. The use and adaptation of commodity control schemes to secure artificially high prices is a throw-back to the worst controls of the inter-war period. Moreover, Johnson's own analysis of the difficulties of stabilizing the prices of primary goods by means of price agreements and export quotas indicates that this device will not even promote resource-transfers except in the case of a handful of commodities where monopoly pricing is possible and where there is little risk of substitution—e.g., coffee, tea, cocoa, bananas, tin. Even in that limited group, which accounts for less than 12 per cent of the total exports of the less developed countries, there are substantial problems. Indeed, if one excludes coffee and tin, which are already subject to commodity agreements, the figure drops to 4 per cent, and for a number of reasons the prospects for banana and tea agreements are dim. At least four years of efforts to secure a cocoa agreement have not yet resulted in its conclusion.

My major quarrel with Johnson is this willingness on his part to accept as "second best," and thus indirectly to encourage, very poor and thinly disguised aid measures in the form of the "trade" arrangements which UNCTAD has been publicizing for the past three years. In so doing, he and the UNCTAD spokesmen are jeopardizing prospects for the adoption of the very measures—greater foreign aid and less protectionism in developed countries for cotton, sugar, and other large exchange-earners—which they both acknowledge will bring about the substantial resource transfers to developing countries they both regard

7. Rowe, supra note 5, at 215.
8. Id. 216.
as essential. In place of such measures, they are prepared to acquiesce in insubstantial and relatively worthless assistance.

It is a very bad bargain indeed. The worst of it is that it could succeed: some developed countries might well prefer it because it is such a low monetary price for them to pay, because it does not require either increased foreign aid appropriations or the sometimes painful political and economic readjustments attendant upon a reduction of protectionism, and because "they" want it. But if they do so, the result can only be deep disappointment and cynicism among the peoples of the developing countries once they realize how badly they have been misled into thinking that their efforts to escape from misery, ignorance, and squalor would be materially advanced by such inadequate remedies. Such a frame of mind would augur ill for rational policies of any kind.

One need not agree with all of Johnson's conclusions or suggestions to appreciate the excellence of his work. It is in my opinion the best general book on the subject now available—thoughtful, well-written, and provocative.

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