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TWELVE

Heller's "New Dimensions of Political Economy"

THE GODKIN Lectures that Professor Walter Heller gave at Harvard University in March 1966 are expanded in his lively book on "New Dimensions of Political Economy." Its central theme is the use of economics in the formation of national policies during the 1960's—a period and subject of which Professor Heller has exceptional firsthand knowledge. The first chapter deals with the role of economists, particularly the Council of Economic Advisers, in shaping economic policies and in advancing the President's program. The second chapter discusses the tools and achievements of the "new economics" since 1961 and "the promise of modern economic policy" for the future. The third and final chapter is devoted to a close examination of the opportunities that growing federal revenues provide for strengthening the fiscal foundations of hard-pressed state and local governments. Clearly, Professor Heller deals with issues of large significance for the modern world.

His book has other notable qualities. It is humane in spirit and is concerned with the business of life, not merely economic improvement. It presents a lucid and stirring account of the

Review of *New Dimensions of Political Economy*, by Walter W. Heller. Reprinted, by permission, from *The National Banking Review*, June 1967.

"new economics" in action. It argues eloquently for a strongly activist economic policy, particularly in fiscal matters. It is informed by a thorough understanding of the political process. It seeks to avoid ideological conflict or commitment. And it yields interesting glimpses of the two presidents whom Professor Heller served so ably as Chairman of the Council of Economic Advisers. For all these reasons the book deserves to be read widely.

Not all of the book, however, deserves to be remembered, and the main reason is the author's neglect of history. Governmental concern with economic growth is hardly an offspring of the "new economics." In the nineteenth century, economic growth was a paramount objective of our nation's policy—as the debates and legislation on tariffs, internal improvements, banking and currency, land settlement, conservation, and the state of competition testify. With industrialization and urbanization proceeding rapidly, the business cycle naturally became a subject of large public concern toward the end of the century. Much attention was therefore directed in succeeding decades, first to the prevention of financial crises, later to the moderation of fluctuations in the general price level, still later to the prevention of mass unemployment. After World War II, as the nation's resolve to deal with unemployment became stronger and as evidence that the business cycle was moderating accumulated, interest shifted again to economic growth and economic policy became increasingly focused on the simultaneous achievement, as far as feasible, of full employment, a high rate of growth in productivity, and general price stability. The Economic Report of the President in January 1954 stated the modern view accurately: "The new concept that is emerging in the practical art of government . . . is to subject every act of proposed legislation or administrative decision, as far as that is humanly possible, to review from the

standpoint of the contribution it is likely to make, whether in the immediate or a more distant future, to the attainment of an expanding economy with maximum employment and without price inflation" (Economic Report, p. 112).

Professor Heller brushes aside what happened before the 1960's. He conveys the impression that, at least during the 1950's, the "old mythology and wrong-headed economics" of the budget dominated economic policy (p. 36). He at no time mentions the huge tax cut, or the provisions for accelerated depreciation, or the highway legislation, or the reform of the social security program, or the concern with education and training programs during the Eisenhower years. He notes, to be sure, the restrictive financial policy of 1958–60, but does not refer to the urgent circumstances from which it arose. "At the 1966 Symposium on the Employment Act," he tells us, "there was much talk of the gradual evolution of economic policy . . . But evolution became revolution the moment we had Presidents—and now we have had two—with the Keynesian perception to welcome their responsibilities under the act and to use its mandate and the weapons of political economy to generate . . . prosperity" (p. 12). This vision of a revolution is indeed suggested by the very first sentence of the book: "Economics has come of age in the 1960's." Again, Professor Heller speaks of Presidents Kennedy and Johnson as "the first modern economists in the American Presidency" (p. 36)—a claim that appears to be largely based on their advocacy of a massive tax cut at a time when the economy was advancing and the budget was out of balance. This was undoubtedly a new, significant, and at the time a salutary departure in economic policy. But if the first modern economist in the presidency is to be identified at all, may not this title belong to President Truman who fought so valiantly for the passage of the Employment Act or perhaps to President Hoover who, de-

spite his tragic inadequacy in a time of crisis, was the first incumbent of the White House to deem it essential to use governmental power to moderate the ill winds of the business cycle?

Between 1961 and 1966, production and employment in our country rose substantially, the advance of prosperity became widely diffused, full employment was reestablished, and new doors of economic opportunity were opened to underprivileged citizens. Professor Heller stresses these achievements and he is right in claiming that the federal government played a vital part in bringing about these gains. However, he glosses over the disappointments of the '60's—the fact that extensive unemployment lasted much too long; the fact that disequilibrium in the balance of payments escaped correction; the fact that governmental finances continued to show a deficit even when full employment was reestablished; and the fact that governmental policy released forces which eventually resulted in a new round of inflation.

Professor Heller properly assigns a high role to fiscal policy, particularly the tax cut of 1964, in the prosperity of recent years. But his view that the expansion was "fiscally spurred" (p. 68) is an oversimplification which fails, in particular, to recognize the strongly expansionist thrust of monetary policy from 1961 to 1965. He claims that the "chief reliance" (p. 95) of fiscal policy during 1961–65 was tax reduction, when in fact expenditure increases came to a much larger total than tax reduction. He conveys the impression that President Kennedy's proposal to cut income tax rates worked out precisely as planned, but fails to mention that the tax proposal was accompanied by a plan to raise federal expenditures by nearly $5 billion and that the Congress accepted the former but rejected the latter. And he is surely mistaken in suggesting that Vietnam is responsible for the recent inflation. Many months be-

fore Vietnam was of any financial consequence, evidence of economic strain began to appear—particularly, although by no means exclusively, in the markets for raw materials and skilled labor. Signs of incipient pressure on the nation's available resources, which were already plain during 1964, were ignored or overlooked by the policymakers. In fact, during 1965, with Vietnam beginning to hurt and the economy approaching full employment, the federal government unleashed practically every weapon of economic stimulation—greater monetary ease, lower income tax rates for individuals, lower income tax rates for corporations, lower excise taxes, and larger spending on programs of the Great Society.

The theory of the "new economics" has a fascination for the modern generation because of its intellectual elegance and scorn of evil—the evil of inflation no less than the evil of unemployment. In Professor Heller's words, the "success of the 'new economics' . . . requires willingness to shift or reverse gears" (p. 99). More precisely, "flexibility of program calls for a readiness to move taxes and interest rates up as inflation pressures mount and down as demand ebbs" (p. 100). But this fine rule of symmetry was practiced unevenly by policymakers during the 1960's—as it had indeed been before them, thereby strengthening the fears of many that the "new economics" may in practice be just another engine of inflation. Even now, Professor Heller does not stop to ponder or even to note the fact that the wholesale price level rose 4 per cent between mid-1964 and the end of 1965. Even now, he believes that economic conditions required "overt fiscal stimulus" (p. 95) during 1965. Even now, while he takes pride in the boldly expansionist policy that was pursued when unemployment was extensive, he explains the hesitations of fiscal policy during 1966 on the simple ground that "the economic calculus was clouded by uncertainty" (p. 88).

Professor Heller professes little interest in the business cycle. "Gone is the countercyclical syndrome of the 1950's," he announces in the Preface. Later, he explains that closing of the gap between actual and potential output "rather than the smoothing of the business cycle became the main preoccupation of policy" (p. 64); and that "the main instrument for dethroning the cyclical model and enthroning the growth model has been the GNP or performance gap" (p. 62). Apart from language, I am unaware of any real difference between "gap-closing" and "smoothing of the business cycle" provided, of course, that the smoothing is substantial and occurs at a high level of the employment rate. There is no real difference here between the objectives of economic policy during the 1960's and the objectives during the 1950's. However, "enthroning the growth model" cannot of itself rid the economy of the processes stressed by business-cycle theory—for example, the imbalance that normally develops between capital investment and consumption or between costs and prices as the economy moves toward full employment. The "cyclical model" therefore serves a diagnostic purpose and its neglect can prove serious, as it indeed has. Fortunately, "the countercyclical syndrome of the 1950's" is not yet entirely "gone." It has not even been entirely abandoned by Professor Heller, for he too recognizes the need "to avoid the excesses that destroy expansions" (p. 49).

The unique function of the Council of Economic Advisers, in Professor Heller's well-chosen words, is "to put at the President's disposal the best facts, appraisals, and forecasts that economic science, statistics, and surveys can produce" (p. 16). But, as he explains, the activities of the Council extend beyond giving advice to the President himself. Professor Heller discusses perceptively the activities of the Council since 1961, but he again fails to do justice to earlier history. He conveys the impression that prior to 1961 the Council pursued a "detached,

Olympian, take-it-or-leave-it approach to Presidential economic advice" (p. 15).[1] This description may fit the brief period when Dr. Nourse was Chairman of the Council. Otherwise, it is simply untrue. During 1953–56, for example, the Chairman of the Council had weekly scheduled meetings with the President—a privilege that only one other member of the government, the Secretary of Defense, enjoyed. He had full access to the President at other times and he used it when necessary. He represented the Council at weekly Cabinet meetings, made frequent reports on current and emerging policy requirements, and participated actively in Cabinet debates on economic matters. He served as Chairman of various Cabinet committees and used the opportunity to advance the Council's program. He worked closely with the Secretary of the Treasury and the Chairman of the Federal Reserve Board. He and his Council colleagues spent a good part of practically every day striving for a consensus on policy issues with representatives of the various departments and agencies. The Council thus fought tirelessly within the Executive establishment for the policies that it deemed needed and proper. The Council did not, however, take to the stump and fight in the public arena for the President's program. It refrained from this essential political activity because it felt, by and large, that professional economists should stick to their knitting, that economic counseling and political advocacy could get in one another's way, and that economists should not devote their precious time to do what politicians—who at least then were not in short supply—can do better.

In other periods, both before and after President Eisen-

[1] Professor Heller has written me as follows: "Because of the context in which they were put, these words apparently conveyed the wrong impression. They were meant to apply to Dr. Nourse's well-known, but unique, concept of Presidential economic advice."

hower's first administration, the Council did indeed choose to play a large and active public role. Since 1961, as Professor Heller explains in detail, the Council has considered its advisory responsibility to include public advocacy of the President's program and even the occasional release of trial balloons in his behalf. It may not be easy to decide, on the basis of evidence yet available, whether such activities seriously interfere with the objectivity and receptiveness to new thought and fresh evidence that the Council needs to have. It is still useful, however, to remember that political activities on the part of the Council nearly led to its destruction not too many years ago.

Whatever view one may take of Professor Heller's treatment of the past, his views concerning the future are always important. His plea for revenue sharing with the states and localities is well reasoned and well documented. It has already aroused wide interest in the Congress and will inevitably become a subject of lively debate once the pressure of Vietnam on the federal budget eases. Professor Heller also makes an impressive plea for flexibility and speed in fiscal action. Since changes in tax rates affect swiftly the income structure, he feels that "high-speed income tax legislation, quickly translated into changes in withholding and quarterly payment rates, would give the Federal Reserve Board a run for its money in timely stabilization policy" (p. 102). This is difficult to achieve under our form of government, and the subject deserves the most careful thought and study—as Professor Heller urges.

Candor compels me to add that my enthusiasm for high-speed tax legislation, which was once considerable, has waned in recent years. I am not at all confident, by way of example, that fiscal policy in early 1966 would have been less hesitant if "pushbutton procedures or Presidential authority for temporary tax increases" (p. 98) had been available. With such de-

vices at hand, we might very well have had a "quickie tax cut" in the summer of 1962, such as the Council then recommended (p. 33). But in that event, would we have gotten the judicious and well-balanced Revenue Act of 1964 which became law only after Congress had worked long and conscientiously on the economic, ethical, and administrative issues surrounding the income tax? Besides doubts of this character, I do not think that economic forecasting is as yet sufficiently accurate to justify fine fiscal tuning. I also fear that if it ever becomes governmental policy to move income taxes up or down at brief intervals, this rule of fiscal behavior will become a normal part of expectations and the effectiveness of fiscal policy in inducing needed changes in investment and consumer spending will therefore be drastically reduced. Thus, if a tax reduction is deemed to be temporary, it will affect economic activity only through its effect on current disposable income and the spending response may be quite small. On the other hand, if the tax reduction is expected to be permanent, both individuals and corporations will not only be more willing to commit their larger disposable income, but they are also apt to use their brains, their energy, their liquid resources, and even their credit to take advantage of the new environment in which business is to be done. These considerations argue against frequent changes, but not necessarily against speedy changes, of tax rates. It would be helpful to learn what we can from the experience of Great Britain, Canada, and perhaps other countries where quick tax legislation has been practiced.

Let me say, in closing, that Professor Heller's optimism and his compassionate concern with both the present and future are perhaps the most engaging features of his book. His faith in the power and promise of the "new economics" is strong. The following is a typical utterance: "I count on our growing economic maturity to keep on lowering the political barriers to

sound economic decisions" (p. 97). But Professor Heller is realistic enough to recognize that the path of the "new economics" is strewn with rocks in practice. His warning that "if fiscal and monetary policies are consistently less vigorous in checking overexpansion than in combatting underexpansion, the resulting inflationary bias could in part discredit the 'new economics'" (p. 50) is timely and constructive.