

- Welcome once again, as MIT professor Paul Samuelson discusses the current economic scene. This series is produced by Instructional Dynamics Incorporated. This program was recorded September 10th.

- The news has been coming thick and fast. Today, I'd like to report on the first summit meeting, the first preparatory meeting for the summit called by President Ford for the major, grand, glorious, 1,500-person summit which will meet at some Washington hotel at the end of this month. On Thursday, September 5th, 28 outside economists were invited to meet in the east room of the White House with President Ford, with his economic advisors, Chairman Alan Greenspan newly appointed to the Council of Economic Advisors, being in the chair for most of the day when the president wasn't there. But included at the table were Roy Ash, the director of the Office of Budget Management, William Simon, Secretary of Treasury, all the other economists, Dr. Fellner of the CEA, Dr. Seevers, and so forth. But also, and this was therefore to be not just an executive branch meeting, but a combined operation, a honeymoon coupling between Congress and executive, also present at the table were senators and congressmen. Senator Proxmire was there, Congressman Patman was there, John Rhodes, Dominick, so you see we had people from Congress both from the liberal and the more conservative persuasions there. Who were the economists invited? Well, I think they were a fairly predictable list of names once it was decided that it was to be a broad spectrum meeting. For example, John Kenneth Galbraith was included, and I take that to be a signal that people off the mainstream of conventional economics were to be represented there. In addition, there was a professor who was about to go to the Hoover library who would be, I suppose, presumed to represent a more conservative viewpoint. Now, of course you can't have everybody. Lacking, notably lacking, from the standpoint of an inside professional was that there was no invitation to Gardner Ackley, a former chairman of the Council of Economic Advisors. But perhaps it was felt that Otto Eckstein, Arthur Okun and Walter Heller were enough of a representation of his view. Also not present was professor James Tobin of Yale, who represents a view discernibly different from that, let's say, of Walter Heller, and perhaps of somebody like myself. But again, it may have been felt that you can't have everybody represented. And Richard Cooper of Yale, formerly provost, now returning to be a professor of international economics at Yale was there, and he did, as it happens, in giving his view, also give some of the views of Professor Tobin. Well, Professor Milton Friedman was there, Professor Beryl Sprinkel, the monetarist, was there. We did not have Alan Meltzer and Karl Brunner, other monetarists, represented there. But, by and large, there was a pretty good representation. I should say that Herbert Stein now a professor at the University of Virginia was, of course, invited there, and Paul McCracken, formerly a chairman who also seems to have some personal relationship with the new president was there. There were some people from, I guess you would have to say industry and labor, for example there was a representative there from the CIO AFL, AFL-CIO, and there was a representative from the Chamber of Commerce. It was very pleasing to see that there were a couple of women there. There was, and by the way, in my judgment, they performed among the outstanding performers there. Marina Whitman, formerly with the Nixon council and an expert in her own right in international economics, was there. Norma Pace, from the Paper Institute was there. There was an economist from IBM, there was an economist from Armstrong Corp, there was an economist from the Bank of America, so I suppose you could say there were some people who had met a payroll there and who were

practical. I must not omit to mention that George Schultz, formerly secretary of treasury, but now at the Bechtel Corporation on the west coast and in a part-time relationship to Stanford Business School was there. The face lacking, missing, was Pierre Rinfret. It had been announced that he had been personally invited by the president. I suppose this must have been announced by Dr. Rinfret himself, but that the staff had vetoed the president's invitation. Well, you can't have everything. Now, what could have been expected before the meeting, and what happened at the meeting? Before the meeting, I don't think you could expect too much of any importance and after the meeting, I think that history will record that that expectation was correct, because after all, the views of all the people at that table have been made available to the public and made available to the government, long since. My own fear was that the only purpose of the summit, once the president had committed himself to it, was going to be an anticlimactic purpose but that the usefulness of such a summit meeting, preliminary summit meeting but I go for all the meetings and the final, big summit meeting is not to discover new truths. You can't expect new anti-Keynesian theorems or pro-Keynesian theorems or quite in different ballparks from Keynes theorems to emerge from a brainstorming session in public by a group of experts like that. The truth is found in the solitary study, in the seminar room, even in bathtubs, not in public committee meetings like that. So I said to myself, what purpose could this serve? And I concluded that such a conference can sometimes be successful when you have a position to sell, a position that most men of goodwill agree with and what you need is a blue-ribbon certification of that, a public relations kickoff, and this was, to me, a very foreboding and pessimistic conclusion, because I asked myself, what is it that anyone could imagine, anyone in Washington, that is, that would constitute such a program? And the only program that I thought of that people could agree on and which would need selling would be a program of blood, sweat, and tears. What you have to do is to tough out this period of stagnation, it hurts you, but it's really good for you and what we need to have is the American people back up the view expressed by so many economists of the previous administration that, to put it bluntly, what the country cannot avoid, what the country actually needs, what the country will be better off for is 6+% unemployment for a long, long time. Indeed, the daydreams of a Washington administration economist, if I use my ESP, I think it's not very hard to paint what is in those daydreams, it's the following, that we should not have the economy so acutely down as to constitute what the National Bureau of Economic Research calls a recession. But, just on the edge of that particular dividing line, we should keep the economy pretty much flat, definitely growing below the par needed to keep the labor force occupied. So we should hope to have the unemployment rate increase, towards 6%, do something cosmetic and substantive about relieving some of the human suffering, the worst human suffering connected with that, but not all of the human suffering, or else the medicine won't provide its therapy and hold on for about a couple of years, in which case, inflationary expectations will be squeezed out of the system and then, again, I want you to know that I'm quoting the view of one group of economists, perhaps the minority of all economic experts somehow defined, then there would be no reason why we couldn't go forward for the rest of the decade with steady prosperity and reasonable price stability. I'm not sure what numbers would correspond to all that, but I think I'm not caricaturing the position if I say that the price level, as measured by the Consumer's Price Index and the GNP deflator, presumably needn't grow by more than an average of two or 3%, the last part of the decade, after the middle of the decade, and that the real growth for the economy could be pretty steady, averaging about 4% after the shakeout period. Well, to get there from here, what's needed, according to this view, is a austere budget, most of the economists who have this view think that an austere budget is the only good budget anyway, that there's an awful lot of waste in the

federal budget and it is always in season to cut down on it. So what one should have would I presume be a \$5 billion cut, at least, from the next fiscal policy budget, hold it down to below \$300 billion, as Dr. Greenspan said, I'm sorry, Mr. Greenspan, it's not so important that X billion dollars be cut, as that we show a definite new pattern, a definite repentance for the loose budgetary policies of the past, that we'd be on our way towards progress. Of course, what should also take place, according to these economists, is a strengthening of the political hand of the Federal Reserve to keep the rate of growth of the money supply down, to keep it down to a reasonable long-run number, like 4% or 5%, in that particular ballpark, and it would be nice to get 20 out of 28 experts to sign their John Hancocks to such a program. This would put pressure on Congress, in fact, some of the economists of this persuasion think the people are ahead of Congress in this respect and this particular prescription, which doesn't, perhaps, to everybody's ears sound great, is said by these economists to be the best that is really feasible, it just is not possible to avoid having unemployment rise. It is just not possible to have unemployment not rise without bringing us right back to a new twist of the inflationary spiral. And the low two-digits price inflation could begin to turn into something worse, moreover, according to these economists again, the change from low, two-digit inflation which is improving to two-digit inflation which is not improving is going, inevitably, under the American political system to bring in controls and infringements on personal and private liberties so that, although there's a cost involved in this program, anyone who is rational and who values freedom and who carefully puts into the balance scales, on the one side, the cost in terms of some extra unemployment and some sacrificed real growth in the short run, which isn't even a cost in the long run, according to this view, just a trade-off through time. On the other side, if you don't do it, and that's the alternative which we're urged, always, to look at, you will have lost your freedoms and no sacrifice, for a person who really values freedom, is too great to preserve one's freedoms. And it would help some if 20 out of 28 economists were to support that viewpoint. I emphasize 20 out of 28 because unanimity among the broad spectrum group of economists is certainly not to be expected by any reasonable man. Usually about 20 in the crowd go one way, the consensus way, and then you always have another eight, another 1/3 who are distributed on both sides of that consensus, those who think that a more rightward, a more conservative, in the case of fighting inflation, a more contractionary set of policies is indicated and then, of course, always a group on the other side, presumably the AFL-CIO. One would have ordinarily, in most years, thought John Kenneth Galbraith, etc., would be on the other side. Well, that isn't at all what happened. First, it was decided that this should be on television. Of course, this means this is on educational television, it doesn't mean high Nielsen ratings but it does mean any person out in the community who is near an urban area and who wants to follow the proceedings is able to do so. And so you have the spectacle of economists on the air, all day long, if they scratched an ear and were within camera view, then that was transmitted all across our great country. My forebodings were not realized and actually, at the end of the day, when I thought back on my return to Cambridge, on what had happened, I decided that it had been about as good a day as one might have hoped for because what is it that the economists there agreed upon? Well, they didn't agree on anything, if 28 out of 28 is your test, but using my rough rule of, where 2/3 to 3/4 stood, then there was a surprising measure of agreement. For example, at least that number, in fact, probably all but three or four in the room said that it was clear that the Federal Reserve had been too tight. I said that if 23 out of 28 economists say the Federal Reserve has been too tight, it means that they really have overstayed their gambit. Unfortunately Dr. Arthur Burns, chairman of the Federal Reserve was not in the room all day and when this particular type of analysis reached its crescendo, I noted that he was not in the room but I was assured that

a little bird would tell him what went on in the room and when the president returned, Arthur Burns also returned. The president got the message and the Federal Reserve got the message. In fact, just yesterday, the Federal Reserve, through an official spokesman, unnamed, said that it already had turned. It didn't need the advice of those experts, it had its own advice and the change in its reserve requirements on large CDs that are over four months duration, that was a signal of the turn. Moreover, the federal funds rate, which had been above 12% and which is watched as a bellwether, had moved down even earlier to 11 and a half percent. All this news was so joyous and good that the stock market was up for a couple of days in a row, however, lest you think the joy was overdone, the stock market managed to take a very sharp fall, just yesterday, as I'm speaking, but it had another event, for those who want to explain the stock market, to give them a possible explanation. Namely, just three days after this era of good feeling in which jokes about the little brown jug that passes between the University of Michigan and the University of Minnesota were being bandied about at the president's table and the president was being congratulated on no longer having an enemy list and having just a list of friends and a listing of everybody and when I spoke of the need for middle-of-the-road policies and emphasized my strong Midwestern credentials, the president jumped to grab the middle-of-the-road, said he was a middle-of-the-road person and of course, we have no reason to doubt that he's a Midwestern person and all was good feeling but of course, just two days ago, the president, after taking guidance from non-earthly sources decided that he would give an absolute and unconditional pardon to the recent president and this, in the view of short term observers, seems to suggest that the honeymoon's over, so that the middle-of-the-road policy advocated last Thursday by the group of experts will not have a chief executive who has quite as much clout to put it through. But let me stick to economics. On the budget, it was pointed out by very many of the experts there, that the government expenditure, in real terms, in goods and services, or in money terms, has been going down, relative to the GNP in this recent inflation period. After all, there's been a substantial cut in defense expenditures. We've been able to give less support to agriculture, etc., etc. This is particularly true at the federal level. The state and local expenditures have not gone down in the way that the federal have, but that's understandable because of revenue sharing and also because of the needs for schools and roads and other things at the local level. If you add in the expansion of transfers, because we are in a welfare state, the increase of Social Security expenditures and other transfer expenditures of the federal government, then what you find is that the share of GNP, it's really not an appropriate comparison, but let's make it because it's always made, of total government spending at all levels has been flat, it has not been going up in this particular period. I won't go through the numbers with you on this occasion, but if you will look at the unified budget and the budget on national income account and the full employment budget, etc., etc., you will not find that the simple-minded thesis that deficits out of control have caused this last inflation can be substantiated. Quite the contrary. Where you will find an expanding role for government, and this is of importance, and it's something, which by the way, Arthur Burns and his associates should be thinking about all the time is in the intermediate financing level by government of outside government activities, whenever the Federal Reserve is very tough on housing, then Congress and executive arrange to have the government do some floating of bonds by Freddie Mac and Fannie Mae and Jenny somebody-or-other and there's still some more brainchildren to come and if you take in all the borrowing for purposes like this and throw that in the budget of the governments, at all level, then you do begin to see an increasing percentage of the resources of the country, not in government, not by government, but under government, strong government influence, but it would be a very peculiar theory of macroeconomics which could associate the 12% inflation with that

particular factor and none of the experts at that table proceeded to do so. One of the experts there, Dr. Sprinkel, of the Harris Trust in Chicago, did emphasize the money levels of the budget but since the prices which everything, the prices of everything, which are important in deciding what this magnitude is, if he had deflated by that, then he would not have had his point. Moreover, he was the one seeming optimist about what's going to happen to the economy in the next year and he pointed, for example, to the fact that the leading indicators were pretty strong and I seem to recall over the years that Dr. Sprinkel has been one of the important experts interpreting those leading indicators. However, if he still follows that subject closely, he knows very well that many people inside the government and in particular, the Boston Federal Reserve Bank has systemically done what's suggested, namely, to deflate the leading indicators because just to have signs of inflation does not mean signs of strength in the real economy and when you begin to deflate, then the leading indicators are not all that strong. Lemme illustrate for example, if there's a frost in Minnesota and in the Dakotas and in Canada, then grain prices go up to limit in the commodity markets. This contributes strength to the sensitive price index. Well, on a simple-minded basis, the sensitive price index has been one of the leading indicators, but that's really an omen of disaster, not a good omen of strength in the economy when, in the present situation, those prices misbehave and I could go on and enumerate other examples of the inflation that is in the leading indicators. So, to come to the second point of agreement, the majority there indicated that what was crucial was not the cuts in the budget. They were rather cavalier on that particular topic. Thirdly, and this is what was being reflected there by both of these earlier things was there was pretty general agreement that it was not simple demand-pull inflation which we were suffering from. There was a great deal of emphasis placed upon supply factors. Hendrick Houthakker of Harvard, for example, had an omnibus bill with 45 different reforms in it, each of which would hurt some private interest but which would microeconomically improve the performance of the American economy and probably also improve the equity of the American economy and, when put in the for the first time, would make a one-time contribution to reducing the current rate of inflation. I thought that the emphasis upon supply was a good one, but it ought not to have been thought, as it seemed to be thought there, that there was a exhaustive dichotomy between demand factors and supply factors because there was a third factor, which I thought ought to be stressed and it certainly isn't simple demand but also can't be called simple supply. Namely, even when the market demand is soft, even when the supply capabilities of a set of industries is good, let's take the automobile industry, for example, there can be a tendency for prices quoted to rise and for example, Dr. Houthakker said that it was a scandal from an anti-trust viewpoint that General Motors and the other three big companies were raising their prices on autos. Now that's not a supply factor in the sense of a harvest failure but it's an incomes policy worsening. And so, although incomes policy is not the best word, but because my time is short, I'll stick with that, I think that there should have been more emphasis there on the problem of demand, the problem of supply, and the problem of the pricing out, in an incomes policy sense, of each degree of balance of supply and demand. Well, lemme just finish since the time is running out. There was, to me, a surprising amount of support, except it was a minority, definite minority but there were three or four people there who seemed to be favorable to price/wage controls. Professor Galbraith, there's no surprise in that but it seemed as if Robert Nathan, of the consulting firm that bears his name, was in favor of that and it actually shocked and outraged George Schultz, who had been with the vast majority, in fact leading it, in saying that it was time for the Federal Reserve to ease up. Well, all things considered, given that you had 28 different minds there, it seems to me that there was an impressive amount of agreement and I think the agreement was in the direction of compromising with the various evils in the

problem. And I dare say that a service was done, even to those whose major apprehension is with respect to the rate of inflation because what they were advocating was just, politically, not feasible, not in the cards and it was going to be self-defeating. It was going to result in a reversal in the other direction which none of us would want.

- If you have any comments or questions for Professor Samuelson, address them to Instructional Dynamics Incorporated, 450 East Ohio Street, Chicago, Illinois, 60611.