pstau001129001.wav / Tape 132 - Watergate; the money crunch / Duke Digital Repository

---

- 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 July 13th.

- One of our subscribers has written in and asked me how it feels to be on the enemy List of the White House. Perhaps a word or two about that would be in order. All the jokes that you've heard about whether a person is or isn't included on that list, are true. In the present environment in the country, particularly in the academic liberal circles, it is a mark of honor to be on the list and people's noses are out of joint if they're not on the list. It's no exaggeration, I was in Washington testifying for a committee a couple days ago, and complete strangers came up to me in the airport and shook my hand and congratulated me and so forth. But the more interesting and more serious question is, do I really deserve it? Am I really earning my passage on that list? And so I've tried to go back and review what it is that I've been saying in tapes like these. What it is that I've said in Newsweek columns. What it is that I've written in articles in the English newspapers and the Japanese newspapers and what it is that I've said in various speeches around the country. Well, first I have to make clear, that from the beginning of President Nixon's first term, I have never blamed him for the inflation in being. It seems to me that the least that a fair critic can do is to face up to the fact and admit that in 1969, President Nixon inherited from President Johnson, his predecessor, an inflation in being. An inflation in being which was still primarily of a demand-pull type, attributable in the first instance to the re-acceleration of the Indo-China War in the summer of 1965, and that new increase in the velocity of circulation of money, that new increase in government spending was superimposed upon an economy already approaching very close to full employment. It was not off-set by exceptionally contractionary Federal Reserve Monetary Policy and it was not off-set by an increase in tax rates or a cut in civilian expenditures. So on that point my conscience is clear. I did argue very vigorously in the first year of the Nixon administration that the policy of gradualism was a mistake. That it would not break the back of the inflation, it would only prolong the agony. And I wrote at the end of that period that I suspected when the economic historians look back on that period and look for the single big mistake it would be the extreme gradualism. I don't wanna go into the reasons for aspousal of that policy, although I think I know some of the reasons. In part it was simply an extreme reaction against the arrogant fine-tuning retentions of the previous team of economists in Washington, but it was a little bit more than that. It had to do too, with a rather curious aspect of monetarism, one which I thought at the time had no particular rationale in terms of the causal mechanisms of monetarism which I could discern and respect, namely that you move to higher rates of change. Rates of change, of rates of change and deciding what is or is not stabilizing. And the gradualism which we actually saw in the first year of the Nixon administration, was not as extreme, not as immoderate, not as excessive, as what had actually been recommended in one of the working parties of Candidate Nixon. I recall because I was asked my opinion of it by an interested member, whether it was really good policy to have as your program, if say, the rate of growth or money supply has been excessive and has been going at nine or 10% a year, can the country really afford to move to six or seven in one year, and then in another year, to four or five and then finally in the third year, to three or four and I argued that was very bad from the standpoint of optimal control theory. That what you wanna do, is to press down hard on the brake, be ready to release your pressing down hard on the brakes, be ready to press your foot again

on the accelerator, again pumping on brake alternately, rather than that steady gradualist. Of course I was very familiar with this kind of optimal control problem because during the war, I was engaged in anti-aircraft fire control design and we used the Wiener-Kolmogorov theories which have in the post-war period, in the field of several mechanism, become extremely popular, of how to minimize the squared deviations of your message or of your gunfire, how to separate noise from a signal, when of course you don't know what the future of your system will be but where you do have some idea of what the general statistical properties of the system are as determined by past experience. And so from my feel of the general statistical properties, the auto-correlations, implicit and explicit, in the American GMP Vector, I thought that this was a very bad policy. I noticed that Professor Milton Friedman, in his article earlier this year in the Morgan Guarantee Trust monthly letter, himself has changed his mind in part on this. He doesn't go as far as I'm going here. If I understand his argument, and if I am recollecting it correctly from memory, he now believes it would have been better policy to go from an excessive rate say of 8%, immediately to your goal rate, let's say if your goal rate is 4% for the M1 and 6% for M2, and if you decide that that's the way they're related to each other, then he would say, you should go instantly to that rate and hold to it. Now just what considerations in terms of the auto-correlation of the likely noise-signal data and our ignorance about the future, would lead to that being optimal rather than to an overshoot? I don't know. I think it would be a not difficult exercise to work that out but I think it would be a very odd, a concatenation of circumstances under which that would be the case. So if I were having to defend that particular thesis, I wouldn't do it in terms of its optimal control properties. I would do it in terms of the weakness of the human mind or the weakness of the committee system. That what mankind needs is a very simple, shibboleth and a rule which you can sell in which mankind can understand, which mankind can irrationally adhere to, is needed. So the argument would go and it's better to just always in season and out of season, insist upon absolute the stability of your input that isn't optimal. But given the weakness of men's minds and committees determinations that would be a second best, which could be defended. Well, it's not for me to make such argument as that, but as I look back on that particular period, I am pleased that I spoke out and I wished that I spoken out a more plunging plea. In particular, there was a period back there when the old definition of the money supply, made it seem as if the Federal Reserve was being a rather beastly in the views of those who believe in a standard fixed, steady adhered to rate of growth, the money supply. And there was much grieving if you will remember at that time against the wickedness of the Federal Reserve as being over restrictive this during the 69 inflation, this during, the expansion period. And I didn't feel that way, I felt at the time that if that was the consequence of simple monetarism, then that was the reason for discrediting simple mantras because the economy didn't yet feel as if it was too weak. Well, so I'm glad that I asked for even greater tightness by the Federal Reserve at that time. Of course, in the event it turned out that the rate of growth of the money supply when you properly redefined it so as to include the euro dollar market data was right on target. And of course, right on target at a time when we're on an inflation is according to my notions of good optimal control programming, very bad. You're off target, you should be leaning against the wind at that particular time. So, there too, I don't feel that I in retrospect would want to change my criticisms of the Nixon team policy. We come to a third area, the Nixon team policy. Here I must say, we're in an area that involves considerable amount of value judgments. The earlier Nixon policy was not to have any income as policy. I don't know why Pinera Frei, who was the president's so called official economic spokesman in the last campaign and we've been aboard the campaign party as an advisor in the first campaign. I don't know why he wasn't put on the enemy list because he said harder things about the president personally and much

harder things about the president's team. than I have ever dared to say, and you will recall because I've quoted this and I'm only quoted it because Pinera Frei, said it on the airwaves and repeated it and lectures about 10 times twice in my presence that he had gone to President Nixon in the early months of 1969 and then told President Nixon that he must use his presidential leadership to help have some kind of incomes policy, some kind of an informal guidepost guidelines policy to hold down the rate of increase of prices and wages. And that the president had said to him that, no, he wouldn't do that, he didn't believe in anything he would work in any case was against his philosophy. And then Pinera Frei went back and sent telegrams to his 500 or 1000 clients saying raise prices, the White House doesn't care, which he boasted, they proceeded to do. Well in this third area then I did criticize the first game plan for completely turning its back on incomes policy. This, by the way, it was not a monolithic policy inside the administration. It's a nearly kept secret that Paul McCracken and when he saw that the other medicine wasn't working, moved gradually towards favoring some kind of incomes policy. And we know in the end that the Secretary of Treasury, Connolly, a non economist captured the president's agreement in August 15th, 1971 we went into phase one. But the record I think is a little more shameful than that because there were a number of people presidential appointees who were fired for saying under oath before Congress when asked whether they thought that some kinds of incomes policy was a good thing, they grudgingly said, yes, they did. And that was considered grounds for dismissal. Well, the president himself threw away the old game plan. He tore it up in August of 1971. I think he did that because he realized that the election was going to be, goes badly in 72 if the country was still doing this badly. And I came out with the writings in which I gave two cheers for his policy. So I don't think that that's a very weak support in this particular case. I very rarely give three cheers to very few of the things that President Johnson, for example, did. Now, as long as we're going into this aspect of political economy, at the time that I received the Nobel award in October of 1970, I was besieged by the press and had press conferences and there was there I think a professional even ethical issue as to whether one should use an occasion like that for giving opinions on policy. You certainly were deluged by questions with respect to policy. And I'll remind you that, that was at the bottom of the recession of 1969 and 1970. We now know, we came out of it in November of 1970 when the General Motors strike was a settled. And I spoke out very strongly and critically. And there I think that, depending upon how you feel about this ethical professional issue, you might fairly introduce some (mumbles) criticism of my particular stand. Well, one could go on and I guess I conclude as I look back over my writings that I feel on the whole, I pulled my punches rather than went out slugging. But I feel on the whole I would do the same thing again because I think you actually gain a credence and you gain weight in political, economical discussions. If you take the less polemical line, what you gain by the polemical clever arguments and humor, in the short run, I think you lose in the longer run and what you lose in the short run, by playing it straight and being if anything leaning over backwards, I think that, you may hope to gain in the long run. In any case, it's a matter of temperament. Now let's turn to more interesting matters to exactly what seems to be going on in the American economy in the summer of 1973. Two things are note-worthy and worth commenting on it this time. First, the suspected weakness in real growth in the second quarter seems now to have been confirmed by the preliminary estimates that are beginning to come out. We went from 7.9% real growth in the first quarter of the year, which is pretty much the way we've been going along for the previous four or five quarters down to below 4%, It now appears. We don't have the official first estimate, but that is the way the experts seem to be sizing this up. We have to ask ourself what that means. Secondly, we've had some developments with respect to the so-called monetary crunch and that's worth commenting on. Let me

begin with the second point. You will remember in earlier tapes I discussed the extremely interesting view of Albert Wildgen one of the First Boston Corporation. He held as early as April of this year, but even earlier, but I quoted his April speech in Boston that in mid-year we'd be in a money crunch. And just two weeks ago, I commented as to whether that had really happened. Well, perhaps we are in a money crunch. It depends semantically on how you define the word crunch, but at least I've seen people in Wall Street use that word as if it was here and now. The Lehman Weekly, a letter on the bond market and interest rates, by Mr. Santo and others, spoke bluntly of our being in a money crunch. What was involved was federal funds rates that aren't six, 7%, aren't eight or 9%, but are at 10% and even for a short periods may go to 15%. The unavailability of certain credit is beginning to be reported in different parts of the country. So some of the conditions which the economic historians use to define a money crunch may already be in the scene. We'll have no argument at all if we say that tight money as measured by a high interest rates, by rising interest rates, by tougher rationing of credit is here. If you wanna call that a crunch, then we are in a money crunch. If you wanna play it safer and speak of pre-crunch conditions as Dr. Otto Eckstein does, then we are further along in the pre-crunch syndrome in the development. This is beginning to have its toll. Just as an example, when I was coming up in the airplane from Washington a couple of days ago, sitting next to me was a civil servant economist in the government and we just happened to spring up a conversation and he told me that his wife was in the real estate business. She is a broker in the selling of houses, and he said that in the last two weeks that money had dried up completely. I said, does that mean she can't sell houses? And he said, of course she can't sell anything unless the buyer will take back a first mortgage for the amount, then he can't sell. Now, economists know from experience that if this happens in the short run, if you wait at a higher and higher price, you'll be able to get some kind of accommodation. Not everybody but people with good jobs and so forth. But in the meantime, there's the real estate agent doing no business, and there are people who want to get rid of their homes who are locked in. That is typical of a crunch when it develops. I mentioned to you that the ramblings that I get from the West Coast, show that already for the purpose of a promotion, you can't any longer raise money for a new suburban shopping market development. This is just not the time. Now, what we haven't got yet is the bank's breathing very hard on dealers in the money market and saying, because your old customers, because we've been dealing with you for years, we'll accommodate you, but we really don't want your business, we want you to cut down. And when that happens, that's very typical of a real crunch. Then these dealers in the money market, no longer will make a market. In other words, somebody comes in with a batch of bonds and wants to sell them ordinarily, they position these but when the friendly banker isn't so friendly and is breathing very hard down on them, then they just won't put in a bid and you can get for a day or two or several days in a row, just sort of no bottom in the bond market. We've had a condition in which government bonds have gone down 100 basis points in a day in recent times. So, measured by what seems to be happening to the rates quoted for loans for investments and the rationing, you would say we were in very tight money and you know, there are at least two different definitions of tight money. There's the effect of interest rates, but there's the other definition which monetarists would insist is the primary one. Some would say it's the only one which they will have any interest in at all and that is what's happening to the rate of growth of money supply. And so paradoxically, we've been having very high rates of growth of the money supply in recent months after low rates in the first quarter of the year. At the same time that interest rates are shooting upward. Presumably, if the Federal Reserve had achieved what must have been its open market committee's primary targets, which we'll read about in 90 days, 90 days after the fact, then if they'd held the rate of growth the money supply down to

what I've supposed as Dr. Arthur Burns and his colleagues have been aiming at, which would be not more than 6%. If they had achieved that instead of the 9% numbers, which were actually realized, then one has to suppose that in the short run, the interest rates would be shooting upward even more strongly. People ask me, what's the matter with the Federal Reserve? Don't they know that the first quarter, second quarter rate of growth of the real output is down? Don't they know that most of the experts using computer models or judgmental models expect that we are already moving into a mini recession and growth recession? Some think we're moving into a real a recession. Why then do they let this money crunch develop? And I think the answer is at first, that the first signs of a turn do not mean that with confidence you can be sure that the turn is already taken place. The Federal Reserve doesn't know that we're now in a mini recession. All it knows is that a very strong, excessively strong first quarter was followed by some relaxation in the second quarter and it will take a good deal more confirmation than that for them to really shift completely around. Secondly, we still have miserable behavior on the price front. The Department of Agriculture has now, so to speak, thrown in the sponge, they've just come out with their very important announcement and what's going to happen to the crop estimates. This is something that every speculator and the Board of Trade waits for anxiously. A scandal like Watergate would be nothing compared to a scandal in which this particular information was made available to private traders for their profit in advance of the official release. Of course that didn't happen. Well, we got the news, namely that the crops look to be good, look to be better than last year. The wheat crop has been marvelous and there's been a lot of acreage. And even though it's a little bit late, in going in the ground, the general total soy bean allocation, corn and so forth, looks to be good. But the spokesman for the Department of Agriculture, I guess the Assistant Secretary of Agriculture had to say at the same time, nevertheless, it looks if food prices are going to go up because this increase in grain will not show itself in the form of an increase in meat, red meat coming on the market. Chickens, broilers in time to dampen down and reduce the very high prices, which we're now having anyway. So it's widely expected outside of Washington and inside of Washington, that after the freeze period is over, which will be very soon after I'm now talking to you, on this morning that there's going to be some kind of upward bulge in prices. Well, the Federal Reserve has a duty to try to keep employment high, to try to keep the unemployment rate down, but it also has a duty and a concern to worry about inflation and increase in price level. Federal Reserve is being screamed at from Paris, from Frankfurt, from Basel because the dollar, except for three days strength based upon a rumor that there was intervention by the central banks of the governments that in other words, if you were having a dirty float, except for those three days, the dollar has been extremely weak. So the Federal Reserve has that reason, to continue to let interest rates rise if that's the way they seem to wanna do when the rate of growth of the money supply is at reasonable level. But the final reason I think why the Federal Reserve is behaving the way that it is, is that although money is very tight, and even crunchy in the credit cost of credit sense, this is all taking place with very rapid increases in the aggregate money magnitudes. In other words, M1 is leaping forward at a very high rate. And as long as that's the case, the Federal Reserve having been under pressure, by the monetarists and by eclectic economists for many years to pay lot of attention to the total of the rate of growth, of money supply, this means that it's more or less in a cliff, a stick. Well now, I haven't much time left, let me in the remaining minutes which I do have, just comment a little bit on what we can conclude from the second quarter weakness in the rate of growth. They're two completely different interpretations possible. First interpretation is the rosy one. I've mentioned this before, I think that Dr. Otto Eckstein of the Data Resources Incorporated, leans towards this, namely that this is moderating the excesses of the boom and it's a good thing. So we should feel a little

more cheerful today than we did two months ago. The opposite interpretation is that of Alberti Summers of the Conference Board. I've quoted his memoranda earlier, on many an occasion because they're worth quoting. Well, I have here his most recent that of July 6th, devoted to what's going to happen in the next 18 months. And to summarize it very briefly, he says that we're still in a raging boom. That the weakness of growth of output is a supply, not a demand effect. I called attention to that and wondered why more people weren't looking into that question. Well, Dr. Summers has looked into the question and as far as he's concerned, it's still is economy running all out and the best thing that can happen would be for the Federal Reserve to be even tighter than it is now. Let me in the remaining moment, just quote the last paragraph of his very interesting piece. The model described here, an economy, that's the model that he's describing in which inflationary excesses and cyclical expansion are being confronted by disinflationary policy much too late. The consequences are a tough than prolonged struggle with inflation and almost inevitable recession. In fact, it would in the end be less painful if policy now we're to relinquish its concern over recession and focus on the need to build a sustainable longer term relationship between demand and supply, that does not depend on mandatory price controls. Any resort to tax increases or selective controls, will bring recession nearer. It would also bring stability and order nearer. For this reason, the application of such devices should be cause for celebration in financial markets. One is tempted to say that recession is no longer a fear of financial markets. It is now nearly a hope. For industrial markets too, the great threat is not recession, but the boundless capabilities for mischief that reside in direct price controls.

- If you have any comments or questions for Professor Samuelson, address them to Instructional Dynamics Incorporated, 166 East Superior Street, Chicago, Illinois, 60611.