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The CEA: An Inside Voice for Mainstream Economics

Charles L. Schultze

Had it not given birth to the Council of Economic Advisers (CEA), the Employment Act of 1946 would have been little noted and not long remembered. The original sponsors of the Employment Act did indeed design a bill—the "Full Employment Act"—to mandate a relatively primitive and highly activist form of compensatory public finance, along with standby appropriations and a commitment to use policy to promote "full" employment at all times. But the ultimate language of the act was quite innocuous, and the commitment to "full" employment was dropped. The act extended the power and authority of the executive branch not one whit, and it provided no standby appropriations for discretionary fiscal measures.[1] One would be hard put to identify any subsequent action by a Congress or a president whose outcome was somehow caused or influenced by the existence of the Employment Act.

The central reason to observe the fiftieth anniversary of the Employment Act of 1946 is, thus, not its charter for a more activist economic policy. Rather, the innovation of the act was the decision to create a Council of Economic Advisers as an independent professional body within the Executive Office of the President, instead of any of the three potential alternatives: an outside "ivory tower" advisory group; a personal economic adviser within the White House itself; or, as in many

[1] See Bailey (1950) and Stein (1990, ch. 9) for a discussion of the history and negotiations that led to the Employment Act.

[2] Both the Treasury and OMB have relatively large economic units, but they do not communicate directly with the president.

■ *Charles L. Schultze is Senior Fellow, The Brookings Institution, Washington, D.C. He served as Chairman of the Council of Economic Advisers during the Carter administration.*

countries, an economic unit within the Department of the Treasury or the Office of Management and Budget (OMB).[2]

The Evolution of the CEA

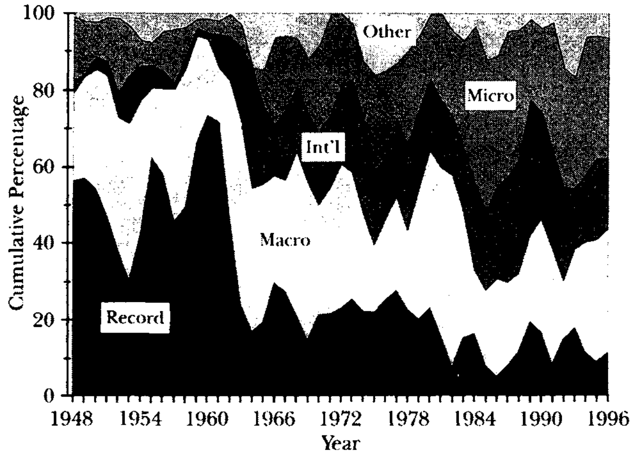
Until the early 1960s, the council followed the intentions of its original congressional sponsors and concentrated on advising the president about issues of macro-stabilization policy. The first Truman council held highly idiosyncratic views of what was needed for economic stability. It had little influence on the macroeconomic policy of the period and was neither asked for nor gave advice on the myriad microeconomic issues that continually flow past the president for decision. The next chairman, Arthur Burns, believed "that there were only a few things that really mattered, that I thought were basically important to the economy" and restricted the range of the CEA accordingly (Hargrove and Morley, 1984, p. 103). Even in the early days of the activist Heller CEA, the chairman told the Congress: "It is not appropriate or necessary for the Council to go into the details of legislative proposals or administrative actions which fall primarily in the domain of operating Executive departments or agencies. . . . Our concern is with the over-all pattern of economic policy."[3]

Gradually, however, the scope of the matters in which the CEA took an interest widened to encompass the entire range of governmental policy with significant economic impact, micro as well as macro, international as well as domestic. This began with the Kennedy CEA when the advisers to the new president discovered—helped along by memos on such matters as agricultural policy from the CEA and OMB—that it was dangerous to lean solely on the advice of the relevant cabinet agencies and their own political instincts on any economic issue. Gradually, it became the custom of the Kennedy and, subsequently, the Johnson administrations to pass all matters with economic significance through the joint screening of OMB and the CEA. Since then, the CEA has been a continuing player in the process that prepares the way for presidential decisions with economic consequences, which includes perhaps four-fifths of domestic policy and a smaller but significant fraction of foreign policy outside the national security arena.

The changing concentration of subject matters considered by the CEA can be illustrated by the space devoted to them in the 49 annual *Economic Reports* from 1947 through 1995. As shown in Figure 1, the proportion of *Report* pages initially devoted to reviewing economic events in the prior year—the "Record"—has generally receded in importance. There has been little change in the attention given to macroeconomic matters and a substantial increase in the discussion of both micro and international economic subjects. When issues of international trade are

[3] Statement of the Council of Economic Advisers before the Joint Economic Committee, U.S. Congress, March 6, 1961.

Figure 1
Subject Matter of CEA Report
(percentage of pages; two-year moving average)



combined with other micro issues, they now typically take up half of the current *Economic Reports.*[4]

The relative time devoted by CEA members and staff to participating in the decision process on microeconomic issues (including trade) is, in fact, greater than indicated by the space devoted to them in the *Economic Reports.* Grand matters of macroeconomic policy—preparing the overall strategy for the next annual budget or deciding whether or not to propose a major tax bill—come up only a limited number of times each year. But the pipeline of issues with microeconomic implications for research, debate and presidential decision is huge. Some micro issues are massive in scope and importance: reform of welfare, Social Security financing, or health care. Many others are individually of much less moment: the annual determination of acreage restrictions under agricultural price supports, the specifics of a trade negotiation with Japan, a draft EPA decision establishing an air quality standard, and so on down an endlessly varied list. As Herbert Stein has pointed out, most CEA chairmen spend more time in deciding "what the price of oats should be" than on the proper size of the budget deficit (Hargrove and Morley, 1984, p. 363). Nonetheless, an accumulation of good or bad decisions over the years even on small issues can make a substantial difference to national welfare.

[4] A number of rather arbitrary decisions necessarily had to be made in assembling the page count for Figure 1. Thus, discussions of various substantive areas that were part of a review of the past year were included in the "record" category; R&D and technology policy was classified as "macro"; discussions of industrial policy were included in "micro"; the "other" category includes discussions of statistical programs, structural tax policy, and income distribution (including the treatment of income transfer programs), but discussions of the minimum wage were classified in the "micro" category. The count was taken from the *Economic Reports* of the councils and excluded the shorter *Economic Reports* of the president.

By the late 1960s, the CEA had evolved into a unique institution for which other major countries have no counterpart. The institutions of policymaking in the federal government are structured to include the CEA as a player at all levels of decision making, up through the final presidential decision. While technically not a cabinet agency, the CEA participates on a level of equality with cabinet members. *In practice, the primary task of the CEA has become one of providing the president with advice on issues with economic content that reflects the analytic approach and the views of the mainstream of the economics profession.*[5]

This view of the CEA's role implies two other propositions: first, that there exists among economists a working consensus applicable to a broad range of policy issues; and second, that economists bring a perspective or approach that differs from the other players in the policy game. These propositions imply that on an important range of issues the CEA will tend to provide roughly similar kinds of analysis and advice to administrations of both parties.

The professionalism of the CEA has to be exercised in a highly political environment. The CEA chairman and members cannot be effective if they are seen as political eunuchs, with little understanding of the political stakes involved. Nevertheless, unlike almost all other top-level appointees, their primary responsibility is not to promote and advance the platform and program of the incumbent president. Seldom cheerfully, sometimes grudgingly, and possibly only after several demurrals by a CEA chair, presidents do come to recognize that fact and expect, if not zero outright cheerleading, less of it from their CEA appointees than from others. White House staff members, who are passionately devoted to the president, can often be less understanding of the CEA role.[6]

Consensus Among Economists?

There is a distinct consensus among economists. It is a commonplace observation that the consensus is greater on micro- than on macroeconomic issues—a point to which I shall return. But even on many macro issues there is a significant area of professional agreement—especially on issues with longer term consequences and, in recent years, on the once divisive subject of the use of fiscal policy for stabilization purposes. Important areas of disagreement remain even within the mainstream of the profession. But even there, the disputants are often arguing about the shape or size of specific parameters within a broadly accepted analytic model.

[5] A number of former CEA chairs and members have articulated similar views about the role of the council. A particularly useful source for reflections and comments of former chairs is Hargrove and Morley (1984).

[6] The reluctance of many CEA chairs and members to engage in highly partisan cheerleading may stem in part from the fact that most of them plan to resume academic careers and so place a high value on maintaining a reputation for professionalism among their academic peers.

Basic Theory Goes a Long Way

Forty years of observing policy debates, including 15 years of participating in them, have not dulled my amazement at how few participants have a grasp of fundamental economic principles and how differently from economists they analyze issues. Several reasons stand out for the wide divergence between the views of economists and others. First, to politicians the world is full of corner solutions; the idea of continuous cost and demand curves with nonzero elasticities is foreign to their way of thinking. Second, some important principles in macroeconomics and international trade are counterintuitive; for example, the essential reason for a country to export is to import, not to increase total employment. In periods of full employment, additional spending on "good things" like exports or investment can harm the economy. The balance between a country's saving and domestic investment is by far the most important determinant of the trade deficit, not "unfair" trading practices by foreign competitors. Depending on costs, there is almost always an optimal amount of "bads" that society shouldn't try to eliminate. Precious few policymakers grasp the principle of comparative advantage.

Third, noneconomists have an almost universal desire to deal with market failures through carefully specified regulation rather than a change in incentive structures.[7] Such specification is the natural function of lawyers, and the legal profession continues to dominate Congress. When government intervenes in the marketplace, our political leaders typically rule out the manipulation of economic incentives to deter undesirable actions because reliance on market responses injects an uncertain, partially random, and therefore "unfair" set of forces into the picture. Yet in the American political context, any use of market forces and incentives for policy purposes would be modest compared to the enormous power that our society readily cedes to the market over a huge slice of our national life.

Sources of the Economic Point of View

The CEA draws upon a shared body of microeconomic doctrine and analytic tools, which allows it to bring to the policy arena a special point of view on two sorts of issues. First, it proceeds on the "rebuttable presumption" that in the long run, markets tend to do a better job than other approaches in allocating resources to their best uses. Economic theory has sought to define rigorously the conditions under which market failure is likely to occur, which helps enormously in weeding out the specious cases for intervention.

Second, when a legitimate market failure does occur, economic thinking can enormously improve the effectiveness and efficiency of the policy response. The political response all too often fails to match the policy instrument to the specific nature of the failure. Thus, the decision (right or wrong) to provide federal support for urban mass transit gave rise to deep subsidies for one factor input—capital—which heavily biased local government choices toward inefficiently capital-rich

[7] For some reflections on why this is so, see Schultze (1977, ch. 4).

solutions. Environmental externalities often beg for incentive-based approaches but are usually treated with detailed regulation. All too often, the political solution to a problem is to smother it in concrete rather than to change incentives; for example, by building more airport runways, highway lanes and flood control projects rather than imposing congestion charges and economically priced flood insurance.

Because microeconomic understanding among many of the players in the policy game is often so low, the injection of basic microeconomic principles, well back from the frontiers of research, can significantly raise the quality of the debate. Of course, I do not mean to imply that the members and staff of the CEA can ignore the latest in research, which can sometimes prove necessary either to design a policy or to ward off misguided action. For example, today's CEA requires thorough familiarity with the literature on the causes of the widening dispersion of wages in the U.S. economy and on the very special requirements for "perfect" health insurance contracts. Estimating the consequences of some protectionist proposal in a complicated market situation may require applying advanced price and industrial organization theory. Nevertheless, for most issues it is more of a challenge to CEA members and staff to translate basic economics into language the other participants in the policy game can understand than to deploy in the debate the latest refinements of theory and econometrics.[8]

In examining how the extent of consensus and controversy within the economics profession has affected the advice given by the CEA, the next several sections of this paper will discuss four sets of issues: microeconomics (including trade policy); the tradeoff between income distribution and efficiency; short-run macroeconomic stabilization policy; and other macroeconomic issues, including the supply-side response to changes in the tax system.

The Role of the CEA in Microeconomic Issues

Democratic and Republican CEAs have tended to take similar stands on microeconomic issues, especially in acting as an advocate for efficiency.[9] CEA staff have carried over easily, and without partisanship, between different administrations. While I have not conducted a survey, I am confident that a large majority of former CEA members would identify OMB as a consistent CEA ally on microeconomic issues, while the Departments of Labor, Commerce and Agriculture are common adversaries. On issues involving the choice between incentives and command-

[8] Richard Schmalensee, CEA member from 1989 to 1991, summed up the point nicely: ". . . the core of my job was not offering opinions honed to perfection in years of academic work. Rather, it was learning about an issue quickly, finding and inhaling some relevant literature (often by calling a real expert outside the Beltway. . .), applying some basic price theory and common sense (often indistinguishable), and thinking about how to express the core ideas involved orally in a few sentences to a lay audience." Letter to Herbert Stein, May 23, 1995.

[9] See Hargrove and Morley (1984, p. 15) for their similar assessment. A number of former CEA members responding to Herbert Stein's requests for "reminiscences" also made the same point.

and-control measures and the weighing of costs against benefits, OSHA and EPA would also typically fall into the adversary category.

The similarity of microeconomic views from CEAs of different political complexions comes through from a perusal of the CEA *Annual Reports* as well as from later public statements of CEA members. The CEA *Report* is, of course, an official document of an administration. But the council has a substantial degree of control over the topics it chooses to emphasize—and to downplay—and this itself can be a tipoff to the arguments it is pursuing internally.

Starting with the Kennedy-Johnson council, every CEA has pushed economic deregulation: in transportation, banking, communications and, more recently, in electric utilities. CEA reports have stressed (with varying emphasis) the advantages of market forces in setting the level and structure of agricultural prices. Since a brief treatment in one of the later Johnson *Annual Reports*, every CEA has strongly advocated explicitly balancing marginal costs against benefits in deciding on environmental priorities and objectives, abandoning the attempt to achieve zero-risk outcomes and substituting reliance on market incentives and signals for detailed regulation. Of course, CEAs have opposed protectionist legislation, championed the trade liberalization initiatives of the past 50 years, and fought for a narrow interpretation of devices to restrict trade.

I spent some time searching for microeconomic issues on which one could detect systematic differences between the Republican and Democratic CEAs. While such differences could be found, a close inspection suggests that the relationship between CEA position and political party was often not simple. For example, in the Eisenhower and Kennedy administrations, the CEA regularly advocated the vigorous pursuit of antitrust policies. Support for antitrust policies continued, but with somewhat more attention to problems and limitations, in the Nixon-Ford years. Reflecting in part that an important segment of the economics profession developed negative views about a wide range of traditional antitrust policies, the CEAs of the 1980s supported, or did not contest, a substantial reduction in antitrust efforts. The Clinton CEA has returned to a somewhat more activist view on this issue.

Since the Korean War, CEAs of both parties have strongly opposed wage and price controls. Ironically, the Democratic CEAs won the internal battles when the subject came up, while the Nixon CEA, despite a vigorous effort, did not. However, Republican CEAs were never supporters of voluntary incomes policies, in contrast to the strong advocacy of such policies and active participation in their implementation by the CEA under both the Kennedy-Johnson and Carter administrations.

The attitude of successive CEAs toward public investments cannot easily be interpreted along party lines. Arthur Burns was one of the most vigorous supporters for launching the interstate highway program, but CEAs under both parties have been skeptical of the deeply subsidized water resource investment programs of the Corps of Engineers and the old Bureau of Reclamation. With regard to federal investments in education and training programs, it does seem that CEAs under Democratic administrations were more likely than their Republican counterparts

to find benefits in excess of costs. But CEAs of both parties supported research to determine the effectiveness of government investments and the use of such research in actual case-by-case decision making.

I draw the conclusion that despite some areas of disagreement, a succession of CEAs under both parties has given similar advice on a wide range of microeconomic matters.

The Batting Record of the CEA on Microeconomic Issues

A huge number of issues with microeconomic content require a presidential decision. Staff work, recommendations and internal negotiations on these issues are typically carried out by working groups composed of representatives from those government departments and agencies that have an interest in the issue. CEA is virtually always included, but often as one among many participants. The CEA carries a little extra influence into the large groups that deal with microeconomic issues, partly because it is a major player in macroeconomic issues which (usually) gives it relatively frequent access to the president, alone or as one of a small group, and partly because it can on occasion point to the macroeconomic consequences of some set of micropolicies. When a presidential proposal is generated, it then has to move through subcommittees, committees and floor votes in two houses of Congress and thereafter proceed through conference committee, further floor votes and presidential signature or veto. Innumerable occasions arise for presidential decisions on proposed amendments, and each decision typically involves complex political calculations that often consume as much or more of the discussion than substantive matters.

While few CEA home runs are on record on this playing field—and indeed, not too many clean singles—some important long-term successes can be identified. The continuing stream of arguments and evidence from economists, transmitted and pursued by the CEA over many years, created a climate for the spate of economic deregulation of the transportation and subsequently the financial industries in the late 1970s and early 1980s. In the Johnson administration, opponents lost the fight to stop federal support for development of a supersonic transport or SST plane, often labeled as the "sure-to-be-subsidized transport." But with strong help from the CEA the SST was killed in the Nixon years. After years of effort on the part of CEA members and staff, under numerous administrations, some economic incentives began to be introduced into environmental programs. Costs used to be given virtually zero weight relative to benefits in environmental decisions, but now the proportional weight has at least been raised up into the double-digit percentages. CEAs in most administrations of the past two decades have continued to wage what has been on the whole a successful defense against "industrial policy," or its equivalent masquerading under different names.

But typically, the CEA influence is felt in more subtle ways, through nudging individual decisions a few degrees closer to rationality. It can convert an outcome from, say, the fifth-best to the third-best by suggesting more efficient ways of achieving some objective, or making the achievement of a "bad" objective less harmful.

It can ferret out the indirect economic consequences of proposals, in the hope of swaying the debate. Perhaps most important of all, the Council can help weed out the really atrocious ideas that pop up in administrations of all hues, often supported by White House political staff or by cabinet departments whose interests are typically coincidental with those of powerful Congresspersons, or allies and "friends" of the president.[10]

The chairs and members of the CEA were seldom political neuters and generally shared the underlying political philosophy of the presidents they served. While both Democratic and Republican CEAs exhibited a strong preference for market or market-like solutions to resource allocation issues, the former tended to be more interventionist minded than the latter. Where the issue was close and professional uncertainty high, Democrats were more likely and Republicans less likely to conclude that the benefits of particular government programs outweighed their costs. Despite this systematic difference, an important element of commonality nevertheless characterized the advice that successive CEAs gave their presidents.

The Consequences of its Professional Role for CEA Behavior

Few policy moves are Pareto superior; even actions with aggregate benefits substantially in excess of costs almost always hurt someone. Direct compensation to the injured is usually impossible, because of the difficulty of identifying or indemnifying specific winners and losers. If each decision is viewed in isolation, the logic of our profession gives economists no warrant to choose the efficient and uncompensable solution, with its widely distributed packets of small benefits and its large losses for a limited number of people. However, by viewing each decision as one step in an endlessly repeated process, I believe that economic advisers can justify consistently opting for the efficient solution in policy debates, in the belief that choosing efficient approaches will in the long run advance the national welfare.

This way of looking at issues throws off a number of corollaries for how top-level economic advisers ought to see their role in the political arena. First, they must accept themselves as role players. Instead of offering advice that seeks to balance economic insights, institutional views, political costs and other considerations, CEA members should see themselves as *partisan advocates of the efficient solution.* Policy debates always include an ample supply of participants who emphasize the concentrated losses and the political dangers that will flow from the efficient decision. If economic advisers do not speak for efficiency, who will?

Of course, this does not mean that the CEA should be politically naive or insist on a "purist" solution to each issue. That would soon render it ineffective. The art of the job is in learning when to compromise and when to stand firm; when to give up front-line defenses and fall back upon previously prepared second-line trenches; when to come up with alternatives that fall within certain political constraints and

[10] A number of ex-CEA members also cited this filtering function as one of the most important and most successful roles of the CEA, as reported in letters from former CEA chairmen and members written to Herbert Stein during summer 1995.

when to persist in questioning the constraints. Cabinet secretaries and White House political staff often present political arguments to advance their own or their agency's substantive preferences; for example, "We must accept Senator *X*'s amendment or the president's bill will be defeated." CEA members must develop some political judgment for defensive purposes—to sense when a political argument is genuine and when it is a cover for pushing a particular substantive preference.

There is another important corollary for the behavior of the CEA that flows from its role as advocate for efficiency. Economic advisers who play the advocacy role I have described have good grounds for leaning in favor of an adequate social safety net. If on a case-by-case basis they deliberately ignore the specific losses generated by efficient solutions, they should (to adapt Arthur Okun's analogy) be willing to accept some loss of water out of the leaky bucket that transfers income as a necessary social cost of moderating the transition costs suffered by losers. This still leaves much room for disagreement, both about how much water will in fact leak out (the incentive question) and how much we want to transfer (the values question). It can be difficult to cushion transition losses suffered by highly specific groups. But some possibilities have moderate costs; for example, a mandate on employers to maintain their contribution to health insurance plans for a transition period after a layoff. Long-run efficiency might even gain from attention to such issues, since public tolerance for the transition costs of efficiency-improving measures may have a modest positive correlation with the adequacy of the safety net.

Finally, most CEAs have performed a mundane but highly useful professional service by regularly providing the president with a brief interpretation of the major incoming economic statistics. This practice offers many opportunities for a bit of economic education and sometimes heads off ill-advised White House statements.

Income Distribution vs. Efficiency

Democratic and Republican CEAs do seem to differ—as did their respective parties—in the weights they attached to reduction of income inequality relative to the promotion of efficiency in considering issues involving the social safety net. (I take up taxes later.) But the distinction between the two sets of CEAs was not always sharp.

Only in *Reports* authored by Republican CEAs does one find any substantial discussion of the employment disincentives of unemployment compensation. But it was a Republican CEA *Report* (1975, p. 124) that summarized its analysis of the program as follows: "In spite of the difficulties inherent in the current unemployment compensation program, it is nevertheless the most effective way of providing financial support for those who suffer a loss of income due to unemployment." It was the Nixon administration that proposed, and a Nixon CEA that supported, both a universal negative income tax and a federal mandate on employers to provide health insurance for their workers.

On balance, it would be a fair characterization to say that when considering

the equity-efficiency tradeoff, the CEA has typically stood closer to the political center than the median position of the most vocal supporters of the administrations under which they served.

Macroeconomics—Stabilization Policies

It is impossible to disentangle neatly the role of the various CEAs in either supporting or trying to moderate the particular macroeconomic policies of the administration in which they served, but one can detect differences in the attitudes of CEAs according to political hue of those administrations. For example, language used in the various *Economic Reports* is different. While the *Reports* almost always declared the importance of achieving both low inflation and high levels of employment, those under Republican administrations tended to give relatively more space and emphasis to the dangers of excess demand and inflation, while Democratic administrations put more weight on the avoidance of recession. But identifying differences in views is difficult since, not surprisingly, the relative emphasis on the dangers of inflation or unemployment also depended on whether the major economic problem at the time was the one or the other.

A more direct way to differentiate between councils is to examine the substance of policies and analysis. Under Burns and Saulnier, the CEA analyzed the pros and cons of applying or withdrawing countercyclical stimulus in terms of the stage of the business cycle—don't stimulate once recovery starts. The Heller council made the switch to evaluating stabilization policy in terms of the gap between actual and potential GDP, an approach that over the whole cycle will be more stimulative—as happened when the CEA in late 1962 began pushing for the "Kennedy" tax cut.

The McCracken CEA refrained from proposing a fiscal stimulus in the recession year of 1970 and urged that the full-employment budget not be allowed to go into deficit. (But a year later the CEA was an advocate of the mild stimulus that the Nixon administration proposed as part of its August 1971 "shock" package.) The Greenspan CEA advocated, and President Ford proposed, a much more moderate economic stimulus at the trough of the 1975 recession than was eventually enacted by the Democratic Congress, acting partly in response to its own informal economic advisers. In 1977, as the recovery from the 1975 recession was entering its third year, the Carter CEA advocated an additional economic stimulus, a piece of advice that almost surely would not have come from its predecessor under Greenspan. And in 1993, the Tyson CEA was an advocate of the small one-time expenditure stimulus that accompanied the longer-term Clinton deficit reduction program.[11]

The differences in attitudes of various CEAs about stabilization policies were

[11] Arthur Okun (1973) provides a contrasting series of short quotes from CEA chairmen and members that nicely illustrates the systematic difference in attitudes toward the inflation-unemployment tradeoff, at least as it existed through the early 1970s.

matched by corresponding differences within the economics profession about the theoretical nature and empirical parameters of the macroeconomic model that would best depict the short-term dynamics of the economy. In earlier days, there were differences over the position and slope of the short-run Phillips curve and, after the 1968 articles of Friedman and Phelps, over the speed with which the short-run curve became vertical. In the 1970s, the onset of the rational expectations revolution and the accompanying "policy ineffectiveness" proposition gave new life to the "rules vs. discretion" controversy. A little later, the advent of real business cycle theory added further possibilities for disagreement. Underlying much of this professional disagreement were differences over the causes of observed wage and price stickiness, the extent to which stickiness would melt away with "credible" anti-inflation policies and the transition costs of achieving credibility.

While the macroeconomic policy advice of CEAs under different administrations can to some extent be differentiated according to the prevailing views of the administrations they served, there is another side to the story. Most of our modern presidents, almost immediately after election, moved away from their campaign rhetoric toward the center. As one consequence, they usually appointed CEA chairs who were pragmatists and centrists, and the chairman in turn tended to have a major voice in picking the two other members of the council, who in turn had a voice in picking staff members. This process is unlikely to select those who have embraced either radical activism or inactivism. Thus in 1969 and 1970, the Nixon CEA adopted a policy of gradualism and careful doses of austerity in the (unrewarded) hope of slowly wringing out inflation without a large increase in unemployment. The Carter CEA took the same approach to fighting inflation in 1979 and 1980 (with even less success).

The essentially moderate nature of the macro advice given by CEAs under both parties can be more easily seen in the context of their fiscal policy recommendations. During the first 25 years of the postwar era, both parties came to accept the inevitability of large cyclically induced budget deficits. Under the tutelage of their CEA chairs, they even came to recognize automatic stabilizing characteristics as desirable. In the 1949 and 1954 recessions, the Truman and Eisenhower administrations did not seriously attempt to balance the budget, and in 1954, prescheduled tax cuts were allowed to go into effect. In addition, CEA Chairman Arthur Burns urged upon President Eisenhower the quick adoption and start of spending proposals that were being considered on structural grounds. The recession of 1958 saw the largest single annual increase in the high-employment budget deficit in the postwar era, some $2\frac{1}{2}$ percent of GDP, not from a tax cut but from a 20 percent increase in the real value of civilian spending.[12] Burns, then an ex-CEA chairman,

[12] On the other hand, appalled by the size of the resulting FY 1959 deficit, President Eisenhower and Treasury Secretary Anderson swiftly eliminated the high-employment deficit in the next year's budget, which, together with a move to tighter monetary policy and a lengthy steel strike, choked off the recovery prematurely.

recommended a fiscal stimulus in the form of a tax cut, which President Eisenhower rejected.

Richard Nixon, guided by the McCracken-Stein CEA and George Shultz at OMB, became in 1971 the first president to propose officially the use of the high-employment budget.[13] In the early 1970s, Congress, whose Appropriations Committees had traditionally been dominated by fiscal conservatives, had swung toward the practice of voting substantial countercyclical spending programs during recessions, principally composed of extended unemployment compensation, accelerated public works and expanded job training programs. The peak of this tendency was reached in 1975 when the Congress sharply increased the modest fiscal stimulus proposed by President Ford.

In the meantime, views within the mainstream of the economics profession about the desirability of discretionary fiscal policy as a countercyclical tool were becoming more cautious. Practical experience and formal research showed long lags in altering the path of spending on public works and other federal purchases (Ando et al., 1963, p. 11). Political reality suggested the danger that antirecession spending programs or tax cuts could become permanent. Developments in consumption theory, using the life-cycle and permanent income approaches, reduced the estimated response of consumption to temporary tax cuts. The views of early Keynesians about the relative inefficacy of monetary policy began to moderate.[14]

These professional cautions reduced but did not eliminate the support of discretionary fiscal policy by successive CEAs of both parties. The Ackley CEA tried to persuade President Johnson to impose a tax increase in 1965 to pay for the war in Vietnam on the grounds that failing to do so would give rise to inflation. The Ford administration proposed a modest fiscal stimulus in 1975, which the Democratic Congress promptly enlarged. The Carter administration proposed a further stimulus later in the same recovery. The 1981 economic program of the Reagan administration constituted a massive fiscal stimulus. Although it was not proposed as a countercyclical measure, the relatively high unemployment of 1981 and the fear of an oncoming recession undoubtedly speeded its enlargement and passage through the Congress. While most Republican CEAs throughout the period continued to be more cautious than their Democratic counterparts about the advice they gave on the use of fiscal

[13] *The Budget of the United States, Fiscal Year 1972*, pp. 9–10; *Annual Economic Report of the President*, January 1971, p. 6. The Heller CEA had much earlier included a discussion of the high-employment budget in its own *Annual Reports*, but until 1970 the concept was never explicitly endorsed in the president's economic or budget messages.

[14] The World War II buildup of excess liquidity, which characterized the initial postwar years and created a relatively shallow slope to the demand for money function, was gradually absorbed by a growing economy and inflation. Whatever residue of the "liquidity trap" that might have existed vanished. Moreover, various institutional peculiarities of the U.S. financial system endowed monetary policy with the effective—even if blunt—instrument of disintermediation to halt booms and reintermediation to help recovery.

policy for stabilization purposes, the difference was one of degree, not of kind.

A number of recent developments have eroded much of the remaining attractiveness of discretionary fiscal policy as a stabilization tool. First, in earlier years, when taxes were not indexed for inflation, and when the federal tax system as a whole was more elastic to changes in economic activity than is now the case, a "permanent" tax cut only temporarily reduced the ratio of taxes to GDP. With indexation and lower elasticity, a permanent tax cut is truly permanent and will lead to larger structural deficits. Thus, countercyclical tax stimulus is now more likely to take the less efficacious form of temporary tax cuts or rebates. Second, while the budget structure of the 1960s and early 1970s spawned a discussion of the dangers of "fiscal drag," in which spending didn't grow as fast as the economy, we now worry about the built-in growth of entitlement programs outstripping the rate of economic growth. Third, with the emergence of large and continuing budget deficits, neither economic advisers nor politicians have been anxious to add further to the deficit.

A final factor has been the increased activism of the Federal Reserve under its last two chairmen, Paul Volcker and Alan Greenspan. Thus, in early 1983, only a few months into the fledgling recovery from the deep 1982 recession, the Fed, facing the prospect of a large rise in the federal government's structural budget deficit, began to tighten up sharply on monetary policy and over the next 18 months pushed up the federal funds rate by 300 basis points (while inflation remained low and constant). Although the primary goal of the increased activism has been the containment and reduction of inflation, several bouts of actual or even incipient economic weakness also triggered episodes of substantial monetary ease.

Even the terms of the dialogue about the effects of budget deficits and fiscal policy have altered sharply. Whenever the first 40 or so *Economic Reports* discussed the subject of excessive budget deficits it was almost always in terms of a danger of inflation. For the Keynesians, the threat was direct; for the monetarists, it was the indirect threat that sustained high deficits would lead the Fed to inflate the money supply. Currently, however, the economic effects of large deficits are almost universally discussed in terms of what they do to national saving rates and interest rates. This is not to suggest that monetary policy has, or could, smoothly offset all of the short-run effects of fiscal shocks. But nonetheless, the greater activism of the Federal Reserve, has for the time being at least, lowered still further the already modest attractiveness of fiscal policy as a countercyclical tool, except in response to very large or prolonged aggregate demand shocks. The Clinton administration did propose a one-year fiscal stimulus in 1993. But it was minuscule in size—$\frac{1}{4}$ of 1 percent of GDP—and its defeat in Congress was widely unmourned. Reflecting both theoretical and empirical research of recent years, the *Economic Reports* of 1991 and 1994 used quite similar language in discussing how a credible and "permanent" reduction in the budget deficit would induce an immediate drop in long-term bond yields, which would moderate any reduction in aggregate demand.

Other Macroeconomic Policies

There are important areas of macroeconomic consensus in the profession on matters outside of stabilization policy, giving rise to corresponding similarities in the advice different CEAs provide to the president. On issues of structural budget policies, recent CEAs of both parties have been leaders within their respective administrations for giving deficit reduction high priority. Most well-known recently are the battles between the Feldstein CEA and opponents within the Reagan administration over this issue and the Tyson CEA's fight for the priority of deficit reduction in 1993.

As I have already noted, successive CEAs have given similar advice on the objectives of trade policy and the determinants of the trade balance. This advice surely represents a consensus in the profession, although it has been counterintuitive enough to elicit strong opposition from some other departments and agencies of government. There is less consensus among economists on the efficacy of sterilized exchange rate interventions, but the differences are not systematically related to political ideology.

Divergence of views over the magnitude of the supply-side effects of changes in taxes has become the most significant area in which there are systematic differences between Democratic and Republican CEAs. The prominence of this issue stems from the emergence in the 1980s of tax reduction as the central economic tenet of Republican administrations.[15] Some of the differences about tax policy stem from the different weights given to objectives of income equality and efficiency by the two parties and the economists they appoint. The differences also reflect a lack of consensus within the profession on the size of the relevant supply elasticities.

But even on this subject, the advice given by CEAs is likely to be more moderate and centrist than the rhetoric and position of the party faithful. Thus, the CEA under the recent Republican supply-side administrations never came close to endorsing the more enthusiastic promises of the payoff from reducing marginal tax rates. Conversely, the economists of Democratic CEAs (often in concert with their opposite numbers in the Treasury) are much more likely than their political colleagues to take account of efficiency considerations in debates over tax policy.

In sum, there has traditionally been less consensus in the economics profession on macro-stabilization issues than on microeconomic policy, and that has been mirrored by differences in the advice given on this issue by Republican and Democratic CEAs. But the contrast between the two sets of CEAs were less than the differences between the political parties; and those contrasts have

[15] Arthur Burns reports an anecdote, described in Hargrove and Morley (1984, p. 117), that drives home the difference between post-Reagan and pre-Reagan Republicanism. George Humphrey, the highly conservative Secretary of the Treasury under Eisenhower, was a rabid opponent of budget deficits. But he once said to Burns, "Why in the wide world are you always talking about cutting the high bracket tax rates? . . . I pay 91 percent and you don't, and yet I don't complain and you do all the time."

narrowed lately. For a wide range of macro issues, there is a reasonable degree of advice-giving consensus.

Some Structural Problems for the CEA

The chair, members and staff of the CEA have to work against several structural barriers in making the institution an effective voice in the ambit of presidential decision making.

First, the CEA is more often the bearer of bad news than most other agencies. Not coincidentally, the CEA (together with OMB) is usually the bane of presidential speechwriters who typically want to promise the moon and the stars from presidential initiatives, or doom and catastrophe from initiatives of the opposition. A CEA that keeps reminding the White House about reality runs the risk of wearing out its welcome. But throughout a presidency, if the CEA does its job well, it is often in the position of reminding presidents that most choices involve tradeoffs, and sometimes telling them that what they can do about some important problem may be worthwhile, but will not produce dramatic results.

Economist-advisers have warrant to believe that their professional discipline offers some unique insights into many policy issues. Especially when the typical policy decision is seen as part of an endlessly repeated game, we economists can have confidence in usually getting the sign right. But the errors associated with our efforts to quantify results are often very large, since the *cetera* are hardly ever *pares*. Thus, justifiable confidence in the policy insights yielded by our discipline ought to go hand-in-hand with a large dose of candor and humility when we essay quantitative estimates of payoffs.

Considerations of honesty in admitting the limits of our knowledge raise, however, a disturbing set of issues. The final outcome of most policy initiatives is a negotiated compromise between the president and an independent Congress. Bargaining considerations typically demand that the initial presidential proposal be stronger (or occasionally weaker) than what is really wanted. How then do CEA members testify that the appropriate dose of policy is X when their best estimate is that it is really $\frac{1}{2}X$ or $2X$? Similarly, in either intra-administration debates or in dealing with the Congress, it is hardly the best negotiating strategy to admit that one is only 60 percent sure of success, to confess the possibility of unfavorable side effects, or to offer modest, realistic payoffs from a policy proposal when all of the other players are promising dramatic results from their own proposals. The ideal of academic research, from which most CEA chairs, members and staff have been drawn, is to publish the truth—warts, uncertainties and all. We do not always live up to the ideal, but we know what it is. Many years of reflection have never revealed to me a way of reconciling the conflicting pressures of negotiating effectiveness and academic standards. All CEA chairs and members must grapple with this problem. Sometimes a fruitful accommodation under pressure is to cultivate an awareness of the virtues of silence.

My main theme has been how the professionalism of the council has led to a useful commonality of advice, even in administrations of various political colors. The political bargaining of 1946 and the strong influence of two early CEA chairmen—Burns and Heller—produced a unique institution, avoiding both the ineffectiveness of an ivory tower "outsider" group and the political bias of an "insider" personal adviser to the president. The Council of Economic Advisers is an institution that has served the country well.

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