

ECONOMICS USA
21st Century Edition

PROGRAM #18

FISCAL POLICY: CAN WE CONTROL THE ECONOMY?

AIRSCRIPT

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Final Transcript

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TEASER

DAVID SCHOUMACHER: 1952. Dwight Eisenhower prepared to take office as the first Republican president since Herbert Hoover. How will he handle his first economic crisis?

JOHN F. KENNEDY: “The torch has been passed to a new generation of Americans...”

DAVID SCHOUMACHER: 1961. John Kennedy has promised to get the country moving again. How will he keep his promise?

BARACK OBAMA: “My fellow citizens. Our economy is badly weakened, a consequence of the greed and irresponsibility on the part of some, but also our collective failure to make hard choices and prepare the nation for a new age.”

DAVID SCHOUMACHER: 2008. Barack Obama comes to office in the midst of a Great Recession. What can he do?

Three presidents, three policies, but one common resolve. The government must never again permit another “Great Depression.” Fiscal policy...Can we control our economy?

That's the question we'll investigate, with the help of economic analysts Richard Gill and Nariman Behravesh, on this 21st-Century Edition of Economics USA. I'm David Schoumacher.

(MUSIC PLAYS. OPENING TITLES)

PART I

DAVID SCHOUMACHER: The twenty years after World War II brought a growing self confidence to American political economics. The lessons of depression and war convinced economists and politicians alike that the government could prevent hardship and promote prosperity by manipulating taxes and spending. These continuing adjustments are called fiscal policy, and for the two decades after World War II each new administration asked itself the same question: How can we use fiscal policy to control the economy?

DAVID SCHOUMACHER: 'I like Ike.' Millions of voices echoed the cry...and it swept Dwight Eisenhower to victory in 1952...the first Republican president since Herbert Hoover. Like Hoover, Eisenhower inherited a prosperous economy...and like Hoover, Eisenhower was forced to watch as that economy slid into a recession. Now Hoover responded with a huge tax increase that deepened the Depression. What would Ike do? Would he repudiate twenty years of modern economics? When Eisenhower took office in 1953, he inherited a prosperity that had been bubbling along since the post-war boom. American factories worked to capacity to fill the demand...then worked overtime to build the bombs, planes and tanks needed to fight the Korean War. Ike promised to end the war..and in July, 1953, he did. But there was little time for rejoicing. By August the economy had stalled. War orders came to a halt and this time there was no explosion of consumer demand to fill the gap. Ike was worried. Where would he turn for advice? Arthur Burns was Chairman of the Council of Economic Advisors. George Humphrey was Secretary of the Treasury. The two did not always agree...

HERBERT STEIN: “He used to say, when Arthur Burns came into the Cabinet room, ‘Well, here comes Arthur with his little kit of tools,’ by which he meant his kit of tools for dealing with the recession, and at various times he kind of got out of line (this is Humphrey who got out of Eisenhower’s line) by saying, ‘Oh no, the idea of increasing expenditures in a recession, that’s really a terrible thing.’ He was more in the Hoover image, but he quickly got back into line.”

DAVID SCHOUMACHER: Ike’s forecast showed unemployment climbing past six percent during the winter of 1954...the highest level since the Depression. Millions of workers were idle and angry. President Eisenhower went to the American people to urge confidence. He predicted that the economy would soon improve and he promised a series of spending programs if it did not. He was ready to take action, but he didn’t have to.

HERBERT STEIN: “If you just keep the tax rate stable for example, then the revenue will automatically fall when the economy falls because people will have less income. The revenue will rise when the economy rises because people will have more income...and that exercises a certain stabilizing effect on the economy. Also, some expenditures will rise in a recession...unemployment compensation expenditures, for example. So, we at the Committee for Economic Development, where I worked, coined that term, ‘a stabilizing budget policy’ and meant it to describe one in which, except in extraordinary circumstances, you rely on these automatic stabilizers.”

DAVID SCHOUMACHER: During the 1954 recession, these automatic stabilizers left an additional \$10 billion in the pockets of American consumers...dollars that would have gone to the Treasury as tax revenue in a healthy economy. \$10 billion helped to fuel the engine of American prosperity and, by the summer of 1954, the first Republican recession since the Crash of ’29 had come and gone...leaving a prosperous economy to continue growing. In the economic history of 20th-century America, the recession of 1954 is nothing more than a wrinkle in the long upward climb of post-war prosperity, but it is significant...because it shows us that by the 1950s most economists agreed that the government not only could, but *should* use fiscal policy to minimize recessions. To the

Eisenhower Administration, that meant taking advantage of the automatic stabilizers in our economy. We asked economic analyst Richard Gill how those stabilizers work...

(MUSIC PLAYS – COMMENT AND ANALYSIS II)

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RICHARD GILL: In 1954, when real GNP began to fall, federal tax revenues also began to fall. Not because of any plan but simply because there was less taxable income. This meant relatively more money in the hands of consumers, which, in turn, meant that private spending did not have to fall as much as one might have expected. In terms of our diagram, what this means is that this private spending curve, instead of going down like this, was flatter...like this. Instead of the economy spiraling down into a Great Depression, private spending was maintained at a relatively high level and the fall in national income was cushioned. One may well ask, if these stabilizers are so wonderful and worked so nicely in 1954, why didn't they stop the Great Depression of the 1930s? The basic answer is that government was already playing a much larger role quantitatively in the economy in the 1950s than it had been twenty years earlier. This was very much what Keynesians of the time were advocating.

PART II

JOHN F. KENNEDY: "I John Fitzgerald Kennedy do solemnly swear...that I will faithfully execute the office of President of the United States."

EARL WARREN: "...that you will faithfully execute the office of President of the United States."

DAVID SCHOUMACHER: The bright promise of that day blinded many to the fact that John Kennedy had managed only a razor-thin margin of victory...and he was taking over as leader of a country that was stalled in a recession and beset by problems of poverty,

pollution, and urban decay. The new President had promised to get the country moving again, but he had no definite program. What would he do to keep his promise? Over the years, John Kenneth Galbraith had provided John Kennedy with answers to economic questions...

JOHN KENNETH GALBRAITH: "I've often said that I went through several stages in my friendship with Kennedy. One was where he would call up and ask me what I thought he should do...this was when he was a Senator. Later, as he grew older in the Senate, he would call up and say, 'What's the reasoning behind all this argument?,' *this* having to do with economics. Then there was the third stage when he acted on his own and didn't bother to call at all."

DAVID SCHOUMACHER: Many predicted that Galbraith would come to Washington with the new administration. Instead, he went to New Delhi as Ambassador to India. Walter Heller was appointed Chairman of the Council of Economic Advisors. He found the new president a receptive pupil.

WALTER HELLER: "He was interested in economics and interestingly enough, somebody who'd known him for a long time, Ken Galbraith, came in to see me before he went to India as Ambassador, and said: 'One of the things you should understand about the President is that he has the capacity to read and to understand' ...and he said, 'Don't be afraid to write to him.' This is very unlike Lyndon Johnson who wanted little short memos. He said, 'Don't be afraid to write him fairly lengthy memos...he'll be interested.' He said, 'just put a little humor in it.' "

DAVID SCHOUMACHER: John Kennedy took office as the country was already beginning its recovery from the Recession of 1960, but unemployment remained distressingly high...and Kennedy's advisors began to realize that the recovery contained the seeds of its own early demise. The government would soon be taking in more money than it was spending. That surplus would stop economic growth well short of full employment.

JOHN KENNETH GALBRAITH: “That could be corrected in two ways: by tax cuts or by increased expenditure. I had the feeling that our social programs at that time, particularly the programs on behalf of the poor, were very much in need of more support...that we had a commitment to the people who were in need...and that was how the money should be used.”

DAVID SCHOUMACHER: But Kennedy’s new economic advisor had a different idea...

WALTER HELLER: “Well, there wasn’t as much disagreement as is often made out to be. I wanted a tax cut surely, but I wanted it as a package...including substantial spending increases. But remember...Kennedy went up to the Hill and got knocked down again and again on the programs and I simply concluded that, as a practical matter, if we wanted to stimulate the economy...if we wanted to get it moving again...we had to have it primarily on the tax side.”

DAVID SCHOUMACHER: Throughout 1961, the economy continued to grow...but slowly. Unemployment was a problem, but not a crisis. Economist Heller saw room for improvement, but politician Kennedy held back. Then in 1962, Walter Heller saw his chance.

WALTER HELLER: “The economy sputtered in ’62 and I pushed hard for a tax cut starting in about March, April. The Treasury resisted a big tax cut. I wanted to have a down payment on it in ’62 to make sure we didn’t fall into a recession again, and then go ahead in ’63. Well, he didn’t buy that...but he did buy, by mid-year in ’62...he bought the idea of an across-the-board tax cut. I remember so well...”

JOHN F. KENNEDY: “Every dollar released from taxation that is spent or invested will help create a new job...and a new salary. And these new jobs and new salaries can create

other jobs and other salaries...and more customers and more growth for an expanding American economy.”

DAVID SCHOUMACHER: Although the President had agreed with him, Heller still had Galbraith to contend with....

WALTER HELLER: “And then, every now and then, his long shadow would fall across the White House when he’d come home for a report from India, and I always knew it because the President would say, ‘Well, Galbraith’s been in here lobbying me again against your tax cut.’ ”

JOHN KENNETH GALBRAITH: “I had access to the President and expressed myself with some vigor...expressed the concern that if we went for tax cuts they would become too popular with Conservatives...and that they would be taken up by Conservatives at the cost to the expenditures that were needed on behalf of needy people.”

DAVID SCHOUMACHER: Despite Ambassador Galbraith’s arguments the President remained committed to his tax cut. The only remaining questions were: when and how much?

WALTER HELLER: “The Treasury, being sort of a keeper of the fiscal keys, was very dubious about a big tax cut. I wanted a \$12 billion tax cut...and they wanted about three or four billion, as they said ‘to lubricate tax reform’...was the term they used. And right after Kennedy gave that speech in August of ’62, saying, ‘yes, we’re going to have a big tax cut and I’m going to present it next January’...Kennedy asked me...he said, ‘What do we do now?’ and I said, ‘Well, we set up the Cabinet Committee on Economic Growth.’ And he said, ‘Well, what’s that for?’ ‘Well,’ I said, ‘that’s for me to get my \$12 billion instead of Doug’s four.’ Well, eventually, and this is a, you know, a slightly simplified version of history, but eventually we compromised on \$12 billion...and that’s the kind of compromise I like.”

DAVID SCHOUMACHER: If the economy wasn't prosperous, it wasn't depressed either. Throughout 1963, President Kennedy tried to sell the \$12 billion tax cut to a reluctant Congress. Then, in November, tragedy struck.

LYNDON B. JOHNSON: "We meet in grief...John Kennedy's death commands what his life conveyed...that America must move forward..."

DAVID SCHOUMACHER: Congress passed the Kennedy tax program and President Lyndon Johnson signed it into law...on March 15, 1964...a monument to a martyred president. The economy immediately took off in a burst of prosperity. Within 18 months, GNP was growing at a feverish five percent. Unemployment had dropped to its lowest level in seven years. It seemed that, in President Kennedy's phrase, a rising tide really had lifted all boats, and on December 31, 1965, the cover of Time Magazine featured John Maynard Keynes...19 years dead but once again a household word. For economists, accustomed to laboring in obscurity, it was a welcome change to bask in the limelight. Just about everyone...journalists, economists, the general public...agreed that the tax cut was an unqualified success. By 1965, it appeared we had finally learned how to use fiscal policy to control the economy. We asked economic analyst Richard Gill why the tax cut of 1964 seemed like such a rousing success...

(MUSIC PLAYS—COMMENT & ANALYSIS III)

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RICHARD GILL: Well, it did seem to work, that is, get the country moving again. And it also seemed a proof of the Keynesian theory, which was pretty dominant among economists by the 1960s. In terms of our diagram, what the tax cut did was simply give more disposable income to consumers. It shifted this whole curve of private spending up like this. The gap between spending and full employment income was eradicated. Of course, it could also have been done as, for example, Professor Galbraith urged, by increasing public spending...leaving private spending where it was and increasing "G," like this. In any case, the apparent success of the tax cut of 1964 was hailed by many as a

total vindication of Keynesian ideas. This was, in fact, the heyday of Keynesian economics. But problems change and so do theories. Within a few years...perhaps even because of the basic success of Keynesian-style policies...we entered a quite different economic world. The wisdom of using fiscal policy to maintain the stability of the economy...in fact, the wisdom of the whole trend towards increasing government participation in the economy...was to come under sharp scrutiny. It's an issue that divides economists to this day!

PART III

DAVID SCHOUMACHER: For more than half a century, the lessons learned after the Great Depression and World War II convinced economists and politicians alike that the government could prevent hardship and promote prosperity by lowering taxes and increasing spending. And it worked. They called it “fiscal policy.” Then in 2010, on the heels of a Great Recession, another president, Barack Obama, would go to the magic potion once again. A massive stimulus package. Could it work? Would it be able to lift the economy back on track?

DAVID SCHOUMACHER: Though President Franklin Roosevelt never understood Keynesian theories of economics, he knew he had to spend to get people back to work. But even the amount spent on the “New Deal” wasn't enough. And in the end, it was the massive spending for World War II that put an end to the Depression. Twelve million men and women were in uniform and 66 million more had jobs to support the war.

As the nation mourned the passing of FDR it wondered about its new leader, the relatively unknown and uncharismatic Harry Truman. But for all his supposed shortcomings, the new president had some common sense ideas on unemployment. Leon Keyserling, an original member of the Council of Economic Advisors, recalls...

LEON KEYSERLING: “Well, Truman was asked, ‘When is unemployment too high?’...and he said, ‘It depends on whether or not you’re unemployed.’ Now this was not a wisecrack. This showed that he had a more fundamental understanding of what the game is about than a lot of later people...because he realized that if you were going to talk you had to talk about people and what was happening to them...and where the hardships were and where the losses were.”

DAVID SCHOUMACHER: More than sixty years later, President Obama also felt the pains of ordinary Americans. Unemployment had soared to a staggering 10 percent.

BARACK OBAMA: “...that I would do all that I could to give every American the chance to make of their lives what they will.”

DAVID SCHOUMACHER: In 2009, he signed into law the American Recovery and Reinvestment Act. The so-called “stimulus package.” It cost \$800 billion dollars. Some Economists believed that this kind of government spending would put people back to work.

ALICE RIVLIN: “I think the stimulus package worked in the sense that the economy did begin growing again, but not as fast as people would have wanted. I personally would have liked to have seen more go out in the form of checks to people who would spend it quickly, that is, more food stamps, more unemployment compensation, and more directly going into pockets of working people, particularly low income working people.”

DAVID SCHOUMACHER: Like Alice Rivlin, a number of economists believed a much larger stimulus was needed to address the unemployment problem. However, others argued that the Obama stimulus had failed.

DOUGLAS HOLTZ-EAKIN: “I don’t think that there’s any evidence that the spending approach to accelerating job growth has been successful. I think there is every reason to believe that if you look at the potential sources of growth...households, not going to

happen...a lot of unemployment...houses aren't worth much...pension plans are shattered...they aren't going to spend money hand over fist.”

DAVID SCHOUMACHER: Did the stimulus work? Former Senator Alan Simpson thought it did.

ALAN SIMPSON: “I’m not good with hypotheticals. Did the stimulus work? Something must have happened. We are still here.”

DAVID SCHOUMACHER: But Douglas Holtz-Eakin believed there was another recipe for growth.

DOUGLAS HOLTZ-EAKIN: “That leaves you the business community...and the way you get them to open up their pocketbooks and spend is to give them confidence about the future. Take off the table the potential for financial crises, or larger future taxes, or big regulatory imposition.”

DAVID SCHOUMACHER: As 2010 came to an end, Democrats and Republicans could not agree on fiscal policy.

In January 2011, in his State of the Union Address, President Obama stressed the importance of growth and future investment.

BARACK OBAMA: “We have to do better in winning the future. So, over the last two years we’ve begun rebuilding for the 21st century...a project that has meant thousands of good jobs for the hard hit construction industry, and tonight I’m proposing that we redouble those efforts.”

DAVID SCHOUMACHER: But for Republicans, the emphasis was austerity. They believed increased deficits would eventually increase interest rates and crowd out private investment. They opted for an extension of the Bush tax cuts for all Americans.

PAUL RYAN: “Spending cuts have to come first. We need to chart a new course. Limited government will unshackle our economy and create millions of new jobs and opportunities for all people of every background to succeed and prosper.”

DAVID SCHOUMACHER: In determining fiscal policy, what role should the government play? How much should we reduce spending?

ALICE RIVLIN: “We don’t want to do that so quickly that the recovery is endangered. The British have decided that they are more scared about future deficits than about derailing the recovery, so they are going for quicker fiscal austerity. I don’t know whether that will work.”

DOUGLAS HOLTZ-EAKIN: “We have to be serious about controlling the spending. If you look around the globe at other countries that have been in this kind of a situation, that have had a simultaneous need to get their budget house in order and to grow, and we need to do both with so many people out of work. That simultaneous set of problems has best been dealt with by keeping taxes low and cutting spending.”

DAVID SCHOUMACHER: By 2011, traditional fiscal policy in the U.S. was still being put to the test. Half of President Obama’s \$800 billion dollar stimulus had yet to be spent by the states and agencies that received the money. The Bush tax cuts for all Americans had been renewed. The President also called for spending to build our nation’s future by investing in American education and business.

BARACK OBAMA: “We’ve faced down impossible odds. We can rise to meet any challenge.”

DAVID SCHOUMACHER: Would it be enough? Or with unemployment hovering at nine percent and the specter of huge deficits and debts staring us in the face, will the once magical potion of fiscal policy be put to rest? We asked economic analyst Nariman

Behraves to discuss the different fiscal policy options for economic recovery and growth.

(MUSIC IN—COMMENT AND ANALYSIS III)

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NARIMAN BEHRAVESH: The decisions about fiscal policy were easier in the depths of the Great Recession than they were two years later when the recovery was underway.

In early 2009, the new President, Barack Obama, and the U.S. Congress, agreed quickly...some would say in record time...on a large fiscal stimulus package. While there is still some disagreement over the size of the stimulus (Was it too big or too small?) and its composition (Should it have included more tax cuts or more spending increases?), there is some consensus that without it the state of the economy would have been much worse. By some estimates, the unemployment rate in the U.S. would have been one and a half to two percentage points higher without the stimulus. That's two to three million jobs.

The challenge in 2011 was entirely different. Given the fragility of the recovery and the large and rising debt of the U.S. Government, the essence of the debate boiled down to two issues: First, should fiscal policy be tightened immediately or later, and second, should most of the adjustment occur on the spending side or the tax side? Few debated the need to cut the deficit and reduce the national debt. On the other hand, there were big differences in opinion about when and how to tighten.

The debate over timing had to do, on the one hand, with judgments about the durability of the recovery and its ability to withstand spending cuts or higher taxes, and, on the other hand, with concerns over the crowding out of private investment by large budget deficits. In the end, the President and Congress agreed to cut spending by only a little in the near term.

The longer-term deficit reduction debate was...and is likely to remain...far more contentious. Republicans prefer to keep taxes low and to reduce the deficit by cutting spending, including the politically sensitive entitlement programs such as Medicare. The Democrats would rather cut spending less and increase taxes, especially on the rich. Political realities will probably force compromise on both sides. Republicans will likely have to live with higher taxes than they would like and Democrats will probably have to accept more spending cuts than they would like.

DAVID SCHOUMACHER: For the last half of the 20th century, the country prospered. No wonder economists were pleased with themselves. The severities of the business cycle had been sharply reduced...and if recession had not been completely eliminated, at least we thought that fiscal policy held the key to ever-increasing growth and prosperity. It might well have been an economist and not a poet who wrote: “Pride goeth before a fall.” The “fall” came in the first decade of the 21st century...and with it would come a new look at the limits of fiscal policy. For this 21st Century Edition of Economics U\$A, I’m David Schoumacher.

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