# Keynesianism, Pennsylvania Avenue Style: Some Economic Consequences of the Employment Act of 1946

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## I. Introduction

The 1946 Employment Act

- established Congress's Joint Economic Committee[2]
- established the Council of Economic Advisers
- called on the President to estimate and forecast the current and future level of economic activity in the U.S., and
- announced that it was the "continuing policy and responsibility" of the federal government to "coordinate and utilize all its plans, functions, and resources... to foster and promote free competitive enterprise and the general welfare; conditions under which there will be afforded useful employment for those able, willing, and seeking to work; and to promote maximum employment, production, and purchasing power" (see Heller (1966), Bailey (1950)).

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[2] I have little to say abou tthe Congressional Joint Economic Committee. At times it has served as an interesting forum for debate on issues of economic policy. The split between the majority and the minority staff has often been very wide, and the standard pressures from other committees seeking to maintain their jurisdiction unimpeded have had the expected effects.

It thus committed the federal government to the business of macroeconomic management.

Or did it?

In 1978 the Humphrey-Hawkins Act required the Chairman of the Federal Reserve to testify before the Congress twice a year on the state of the macroeconomy. It committed the federal government to reducing the unemployment rate to four percent by 1983 *and to maintaining it thereafter*. It also (in an amendment introduced by Orrin Hatch, R-Utah) committed the federal government to reducing the inflation rate to zero by 1988. And it called for the reduction of federal government spending to "the lowest level consistent with national needs," and for spending more money on farm price supports (Weir (1992)).

The Humphrey-Hawkins Act has had no effect, with perhaps a single caveat. The Federal Reserve Chairman does now give his twice-a-year "Humphrey-Hawkins testimony."[3] The workload on Federal Reserve staff economists has certainly increased, as they must now pull together material for the testimony.

Perhaps the general rule is that laws have effects when they create institutions and processes, but that laws that merely establish goals have no independent effects.

However, laws that merely establish goals can and do serve as markers of changes in opinions, perceptions, and aims. People then speak of the effects of the law, but in many cases they are using the law as a shorthand marker of the changes in the hearts and the minds of the people. Whether the goal established is actually achieved, or whether the establishment of the goal then effects and constrains public policy, is

[3] In this sense, there may have been some progress toward the legislative goal of increasing the "transparency" and

determined by the depth of the change in hearts and minds. A law like Humphrey-Hawkins—in large part going against the flow of ongoing shifts in opinion and sentiment, and in large part passed for short-term political advantage because it was expected to be a dead letter—that creates no institutions, and signals no shift in hearts and minds toward its goals, has no effects.

The Employment Act of 1946 certainly signalled the commitment of the federal government to the macroeconomic management business. As originally introduced, the *Full* Employment Act required the president to submit a "National Production and Employment Budget" [NPEB] that would set out a spending and legislative program for the current legislative session that would "assure a full employment volume of production" *in the following fiscal year*—a fiscal year that would begin approximately six months after the submission of the NPEB.

Since no extra funds were to be appropriated for the preparation of the NPEB, the work involved in the preparation of such a program would have been carried out by the then-Bureau of the Budget, the subgroup within the Executive Office of the President that is now the Office of Management and Budget. Such an institutional setup would have solidly entrenched a strong bias toward active countercyclical fiscal policy in the core of the American Executive Branch.

As finally enacted, the Employment Act called for an annual *Economic Report* "setting forth... current and foreseeable trends in the levels of employment, production, and purchasing power... and a program for carrying out the policy" of the federal government to promote "conditions under which there will be afforded useful

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accountability of Federal Reserve actions.

employment for those able, willing, and seeking to work." The enacted bill is a weaker signal of the federal government's commitment to macroeconomic management than was the initial proposal, but it is still a signal.

The Employment Act of 1946 also created the Council of Economic Advisers. But its creation of the Council of Economic Advisers as we know it today—one chair, two deputies, and a senior staff of fifteen, almost invariably drawn from and planning to return to the professoriate—is best described as an *accident*. The original proposal was for an expansion of the Budget Bureau, or perhaps for an "Office of Director of the National Budget." Other institutional arrangements were proposed. House Republicans sought a Federal Trade Commission or Federal Reserve Board-like structure for the Council of Economic Advisers, with members confirmed by the Senate serving not at the pleasure of the President but for five-year overlapping terms. Treasury Secretary Vinson sought a cabinet-level economic policy coordination committee chaired by—no surprise—the Treasury Secretary. The staff of such an economic policy coordination committee would have been composed *not* of economists on one- or two-year rotations from the professoriate, but of the mix of civil servants and ex-campaign workers that make up the operating levels of the White House staff.[4]

My reading of the legislative history is that the Truman Administration dropped the ball on issues of Executive Office of the President organization on which it ought to have had strong views, and that Congress—I believe incorrectly—saw use of the Senate's advice-and-consent power and the existence of an economic policy

[4] Such a cabinet-level economic policy coordinating committee has often existed (and, when it has existed, has often been chaired by the Secretary of the Treasury). The head of such a committee (when not the Secretary of the Treasury) and the staff of such a committee have, however, typically been very different from the members and staff of the Council of Economic Advisers. Compare Roger Porter or John Ehrlichman to Michael Boskin or Herbert Stein; at the staff level,

appropriation line item as tools it could use to influence the macroeconomic policy planning in the Executive Office of the President. Only because of the institution-building of Arthur Burns and Walter Heller did the CEA acquire the recruitment and staffing patterns that it has today.

Thus there are two interwoven strands to follow in analyzing the 1946 Employment Act. First come the institutions established by the 1946 Employment Act: how they functioned, and what the consequences of their existence were. Second comes the shift in sentiments and aims that led to the passage of the 1946 Employment Act, and of which the 1946 Employment Act serves as a convenient marker. The strands are interwoven in part because the Council has served as the channel through which shifts in the climate of opinion have their effect on the Executive Branch of the U.S. government, and in part because the authority of the Council has been in large part derived from the same intellectual and sentimental currents that underpinned the enactment of the 1946 Employment Act.

## II. Stabilization Policy

The largest change of which the 1946 Employment Act serves as a signal or a marker is the post-World War II policy of allowing the government’s automatic stabilizers to function. Not since the Great Depression have mainstream legislators or opinion leaders called for moves toward fiscal austerity in the midst of a recession. As a result, the federal government’s budget exhibits substantial cyclical variation, sliding

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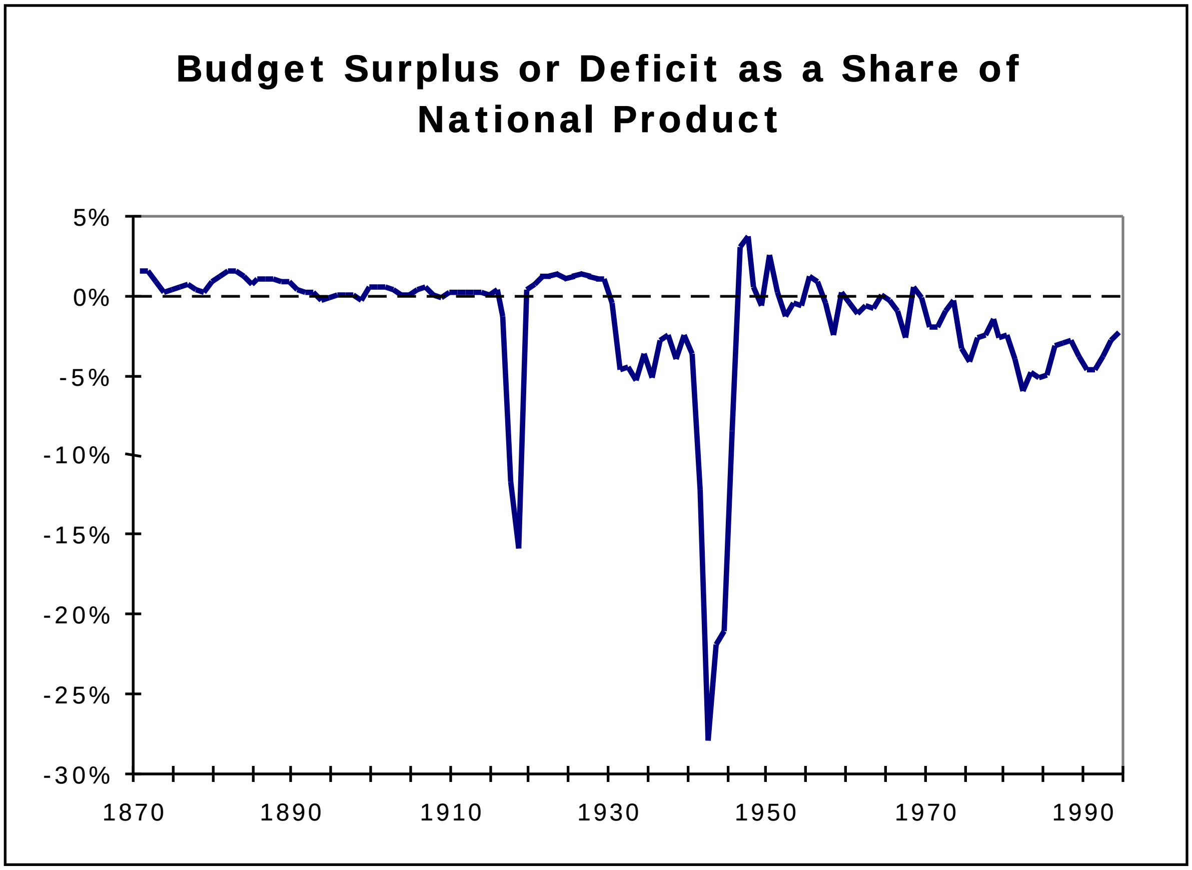
compare James Pinkerton to Susan Collins or Matthew Shapiro.

into deeper deficit in recessions, and moving toward balance or into surplus as the economy expands.




There have been powerful (and I believe correct) arguments that the federal government has neither the knowledge of economic structure nor the institutional capacity to do any more than allow fiscal automatic stabilizers to function (see Friedman (1953); Eisner (1969); Stein (1969, 1980, 1984)). But arguments in recession that the current federal deficit—whatever it may be—is “cyclical,” and that steps to reduce it immediately would aggravate the recession, have been effective trump cards in public policy debates. And since World War II, at least, they have kept policy makers for taking significant steps to reduce cyclical deficits.

Pre-Keynesian Fiscal Theory

The gap between this calm acceptance of automatic stabilizers and the cyclical fiscal deficits they produce and pre-World War II attitudes is very, very large. Recall that Franklin Roosevelt made Herbert Hoover's failure to balance the federal budget in 1932 an issue in the 1932 presidential election. Or consider Joseph Schumpeter, writing from Harvard in the middle of the Great Depression that there was a:

> presumption *against* remedial measures… [because] policies of this class are particularly apt to…produce additional trouble for the future.... [For depressions are] not simply evils, which we might attempt to suppress, but…forms of something which has to be done, namely, adjustment to…change... [and] most of what would be effective in remedying a depression would be equally effective in preventing this adjustment. (See Brown, 1934).

In what Haberler (1937) classified as "monetary over-investment" theories of the business cycle, depressions were born either because of excessively easy monetary policy or because of *ex post* overoptimistic expectations of economic growth. When monetary policy ceased to be easy, or when investors and businesses recognized that their forecasts of future growth had been overoptimistic, the economy was left with a large inventory of investment projects that were unprofitable.

True and sustainable economic recovery was not possible until the economy's overinvestment overhang had been "liquidated"—and the painful depression was this process of liquidation. Monetary and fiscal policies to moderate the depression would, in this conceptual framework, keep workers and firms producing in unsustainable lines of business and levels of capital intensity. Such attempts to alleviate the depression would make the depression less deep only at the price of making it longer, and would add to the total sum of human misery (Hayek (1935)).

Indeed, Lionel Robbins (1934) went as far as to blame the tiny steps toward moderating the decline in the money stock and boosting fiscal demand that governments undertook over 1929-1933 for the persistence of the Great Depression into the mid-1930s.

This doctrine—that in the long run the Great Depression would turn out to have been "good medicine" for the economy, and that proponents of stimulative monetary and fiscal policies in the 1930s were shortsighted enemies of the public welfare—did draw some anguished cries of dissent. Keynes (1931) tried to ridicule this view, which Salant (1989) terms the "crime and punishment" view of business cycles.[5] Ralph Hawtrey (1938), an advisor to the British Treasury and the Bank of England, called it the equivalent of "crying, 'Fire! Fire!' in Noah's flood" (Temin (1989)). Much later, Milton Friedman would recall that at the Chicago where he went to graduate school such ideas were not taught, but that perhaps the presence of such doctrines at other universities

[5] From Keynes (1931): "Some austere and puritanical souls regard [the Great Depression] both as an inevitable and a desirable nemesis on so much [late 1920s] overexpansion, as they call it; a nemesis on man's speculative spirit. It would, they feel, be a victory for the mammon of unrighteousness if so much prosperity was not subsequently balanced by universal bankruptcy. We need, they say, what they politely call a 'prolonged liquidation' to put us right. The liquidation, they tell us, is not yet complete. But in time it will be. And when sufficient time has elapsed for the completion of the liquidation, all will be well with us again....

"I do not take this view. I find the explanation of the current business losses, of the reduction in output, and of the unemployment which necessarily ensues not in the high level of investment which was proceeding up to the spring of 1929, but in the subsequent cessation of this investment. I see no hope of a recovery except in a revival of the high level of investment. And I do not understand how universal like Harvard would induce bright economists to rebel and become Keynesians (see Gordon (1972)).

Automatic Stabilizers

Automatic stabilizers may not have significantly reduced post-World War II business-cycle variability below pre-Depression levels (Romer (1986). And any belief that automatic stabilizers have a significant effect on business cycle variability does depend on liquidity constraints being pervasive in the economy (see De Long and Summers (1986)). Nevertheless, the shift in the cyclical behavior of the federal budget, considered as a sea-anchor for the economy's level of total spending, is impressive.

A good deal of this increase in the magnitude of automatic stabilizers comes from the increase in the size of the government as a share of national product. The post-World War II federal government taxes and spends one-sixth or more of national product in *peacetime*. The Depression-era federal government taxed five to seven percent and spent eight to ten percent of national product. The pre-Depression federal government taxed and spent five percent of national product in peak peacetime periods. In other periods—the first peacetime presidency of Woodrow Wilson, for example—federal revenues and federal expenditures were little more than one-fiftieth of national product.

With a large federal government automatic stabilizers can easily be large: a 2.5 percentage-point increase in the unemployment rate associated with a five-percent fall in output relative to previous forecasts would "automatically" produce a deficit of one

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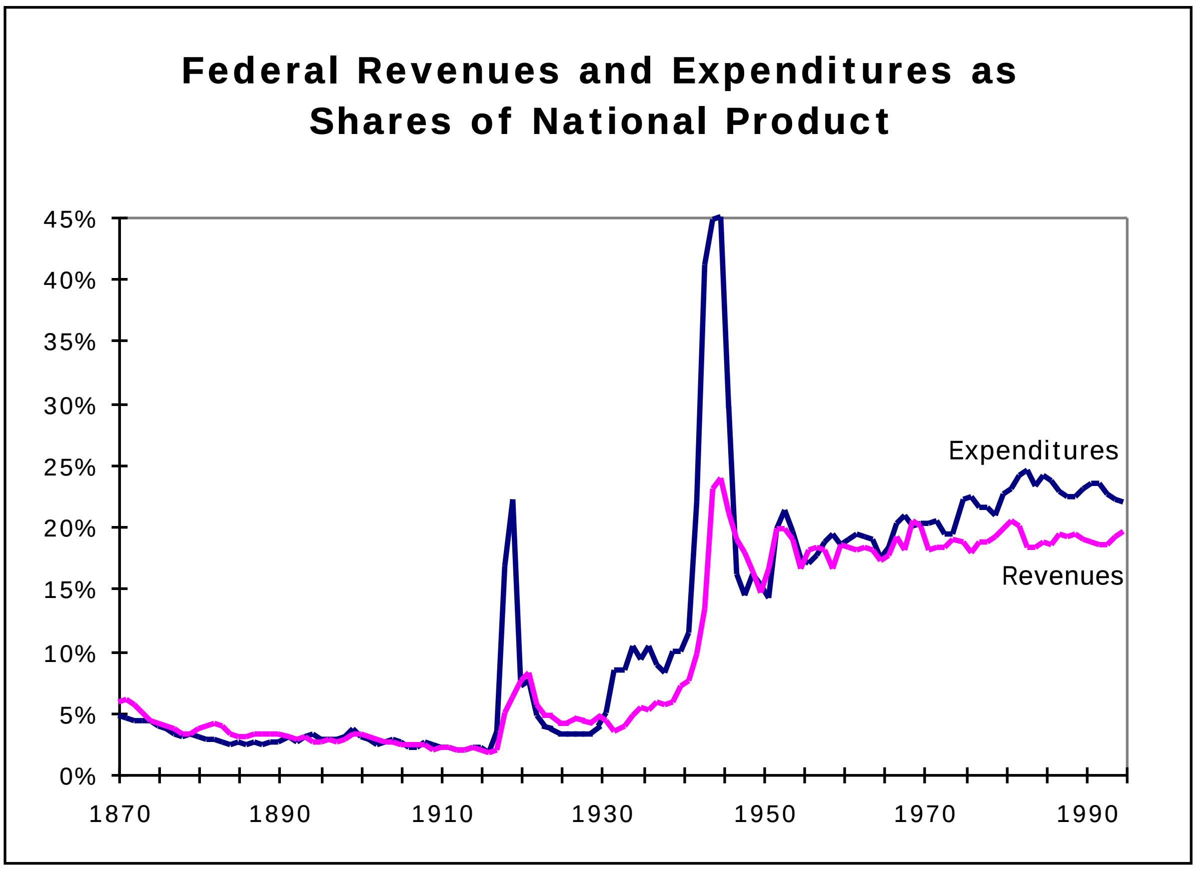
bankruptcy can do any good or bring us nearer to prosperity…"

percent of national product if revenues and spending are one-fifth of national product, even if revenues have a unit elasticity with respect to shocks to production and even if expenditures do not rise in response to unexpected increases in unemployment. When revenues are only six percent of national product the smaller size of the government alone makes automatic stabilizers only one-third as large. And when, as before the Great Depression, both spending and revenues are five percent of national product or less, it is hard to see how "automatic stabilizers" could have any macroeconomic significance.

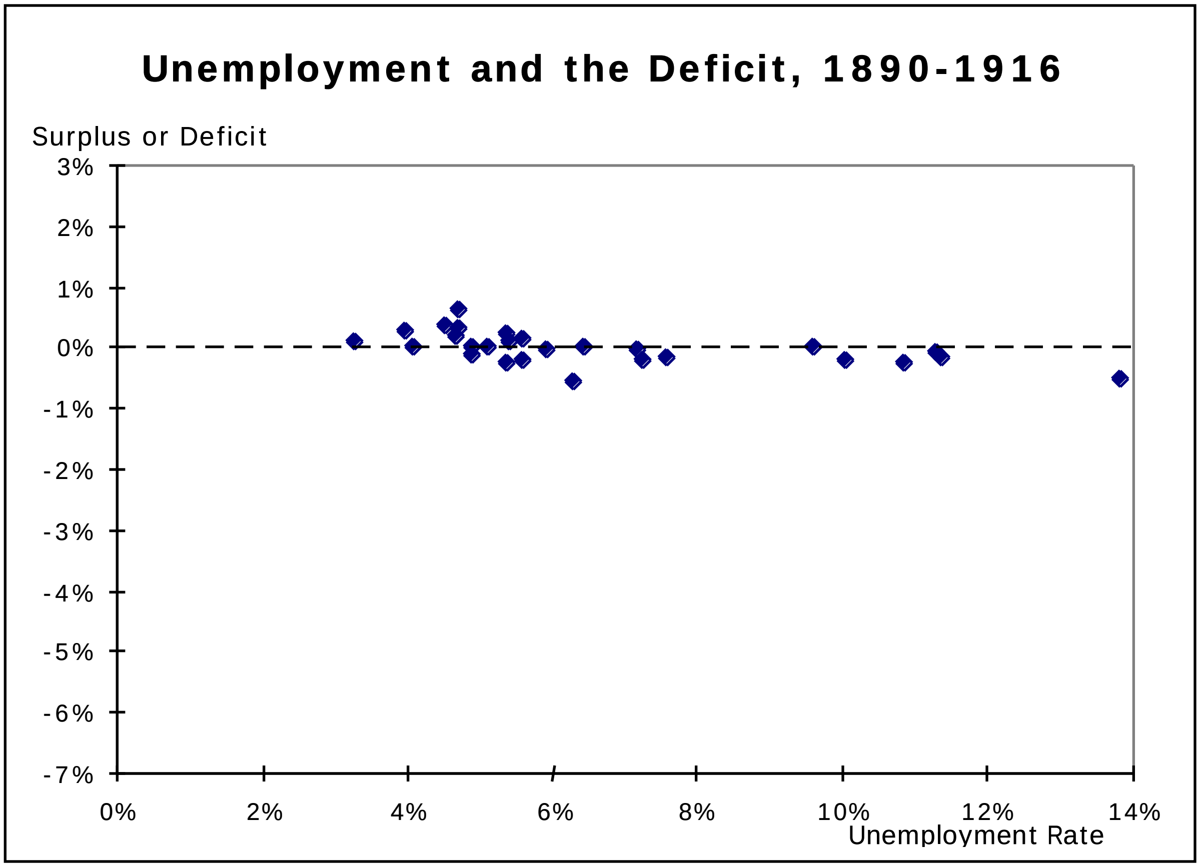


The table below presents simple regressions of the level of the government's fiscal balance as a share of national product on the unemployment rate (using annual data, for fiscal years, applying Romer's (1986) suggested correction to pre-Depression estimates of unemployment rates, and reporting robust standard errors) as a way of summarizing the degree to which fiscal policy stabilized the economy, either through automatic stabilizers that they were allowed to operate (and not offset by attempts to move toward budget balance in recession), or through discretionary fiscal policy.

**Responsiveness of Federal Budget to Unemployment: Pre-World War I, Interwar, and Post-World War II**

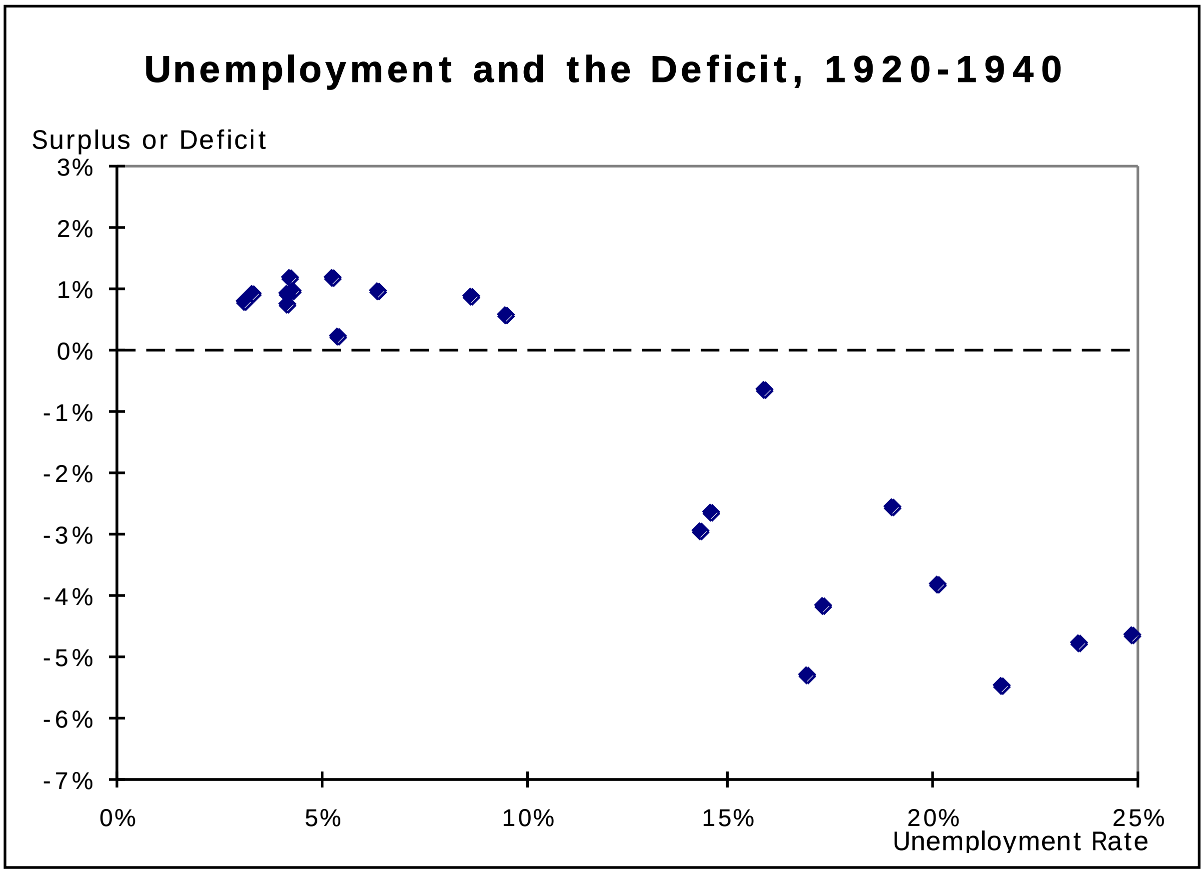
| Period | Unemployment Rate | Post-1982 Period | $R^2$ | SEE |
|---|---|---|---|---|
| 1890-1916 | -0.056<br>(0.023) | | 0.307 | 0.002 |
| 1920-1940 | -0.317<br>(0.045) | | 0.847 | 0.010 |
| 1950-1995 | -0.894<br>(0.188) | | 0.526 | 0.013 |
| 1950-1995* | -0.680<br>(0.127) | -0.021<br>(0.004) | 0.746 | 0.010 |

Not surprisingly, the pre-World War I period shows no signs of automatic stabilizers: the federal budget balance is correlated with unemployment, but the small size of the federal government means that a five percentage-point rise in the unemployment rate would be associated with only an 0.28 percentage-point rise in the federal deficit as a share of national product.

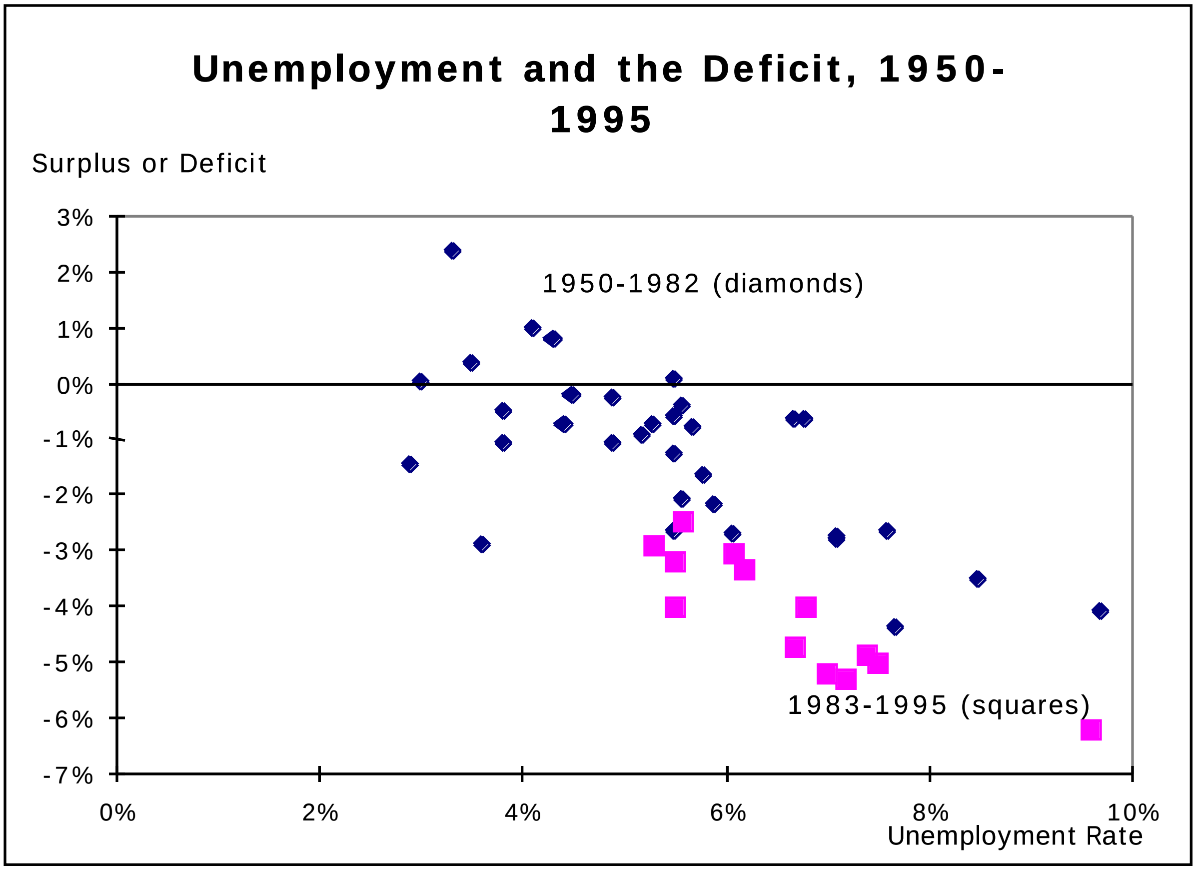



The interwar period—the overwhelming share of identifying variance comes from the Great Depression—shows a degree of stabilization: a five percentage-point increase in the unemployment rate is associated with a 1.6 percentage-point increase in the deficit as a share of national product. The bulk of this stabilization comes on the discretionary expenditure rather than on the tax side: between 1929 and 1933 revenues remained roughly constant as a share of national product as nominal national product fell by more than forty-five percent. By contrast, nominal federal expenditures rose by fifty percent.

The post-World War II period shows the greatest cyclical responsiveness of fiscal balance to unemployment. A five percentage-point increase in the unemployment rate is associated with a 4.5 percentage-point increase in the federal deficit as a share of national product over the post-World War II period as a whole.




If one allows for a shift in the intercept in the early 1980s as a result of the change in America's budget politics brought about by the shift of a large chunk of the Republican party from a commitment to budget balance as the highest priority to a commitment to tax cuts as the highest priority, the stabilization exercized on the economy by the government's fiscal balance appears somewhat smaller: a five percentage-point increase in the unemployment rate is associated not with a 4.5 but with a 3.5 percentage-point increase in the federal deficit as a share of national product.




Post-World War II Discretionary Fiscal Policy

The bulk of this increase, from the pre-World War I period across the interwar period and into the post-World War II period, in the countercyclicality of the government’s budget balance is the result of the growing size of government. The role played by the commitment to macroeconomic management has largely been to check pressures that would have led to procyclical discretionary fiscal policy, rather than to augment the automatic stabilizers created by the size of the government and the structure of its tax and spending policies.

Looking back at the budget since World War II, it is difficult to argue that on balance “discretionary” fiscal policy has played any stabilizing role at all (see Gordon (1980); De Long and Summers (1986)). Walter Heller could find one case of successful discretionary stabilization stabilization policy—the Kennedy-Johnson tax cut (Heller (1966)). But even those who believe early-1960s fiscal policy was a great success find no other examples, and no successful repetitions in which a discretionary fiscal policy intended to shift output relative to potential had the desired effects (see Eisner (1969).

The basic difficulty is that recessions are not expected, are not forecasted, and develop quickly. Economic policy makers are working with shaky data from one quarter or so in the past. The legislative process takes at least two or three quarters. Appropriated funds require at least two more quarters before they can be spent on any substantial scale. And by that time the “need” for economic stimulus has passed. The U.S. government simply lacks the knowledge to design and the institutional capacity to exercise discretionary fiscal policy in response to any macroeconomic cycle of shorter duration than the Great Depression itself.

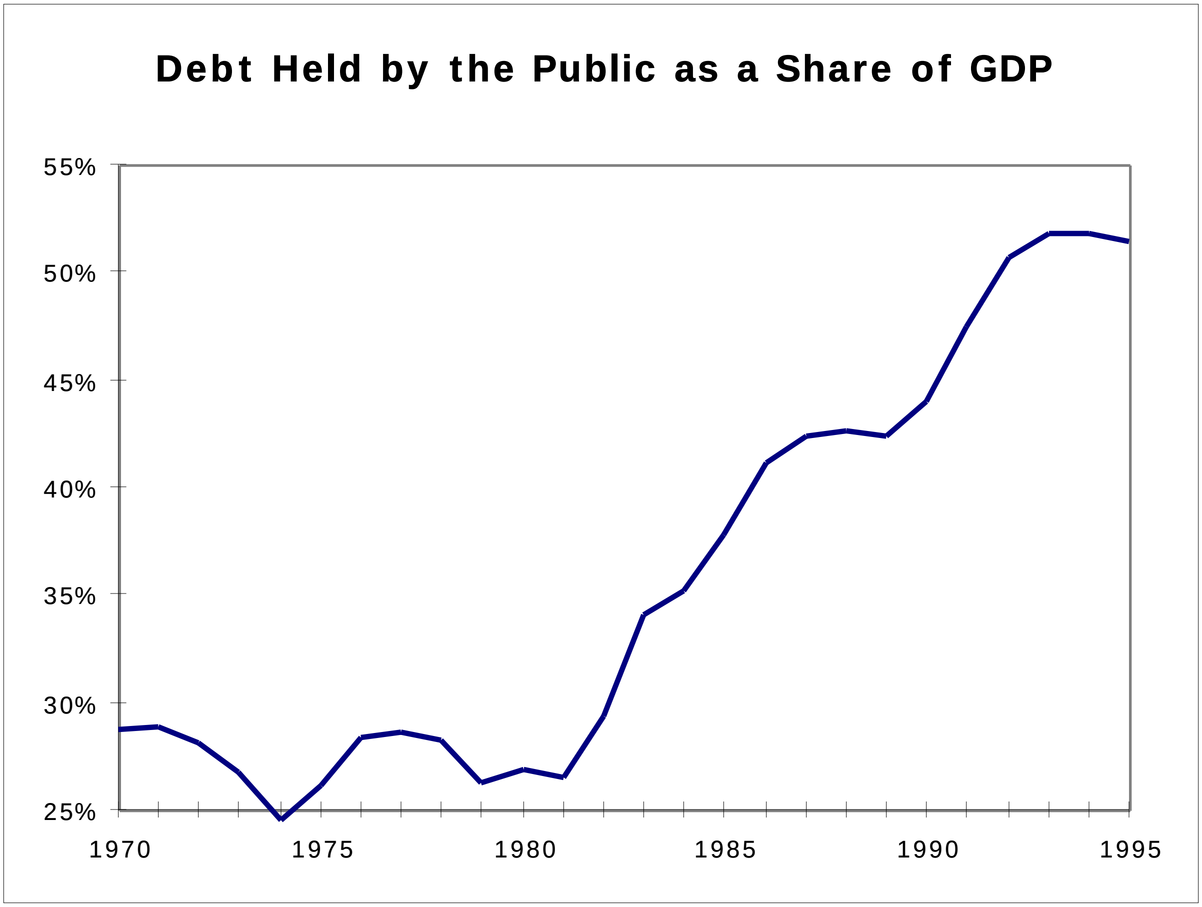
By contrast, automatic stabilizers swing into action within the current quarter. A fall in incomes leads to a shortfall in revenues—and an increase in the deficit—as soon as witholdings reach the Federal Reserve. It is difficult to imagine how alternative policy instruments could deliver such a within-the-quarter response to shifts in spending and employment.

Those who, like me, believe that automatic stabilizers are an important element of the post-World War II economy are in an uncomfortable position in view of Romer's (1969) convincing argument that there has been only a small amount, if any, of stabilization in the post-World War II relative to the pre-Depression macroeconomy. We can point to larger shocks—like the oil-price supply-shock of 1973—in the post-World War II period. We can argue that point estimates do show some stabilization. We can claim that the issue is not stabilization relative to pre-Depression but relative to pre-World War II experience: that the Great Depression is a valid draw from the universe of potential pre-Keynesian macroeconomic experience, and that it is not appropriate to exclude the largest pre-World War II recession from the sample.

I believe these arguments. I make them on at least a monthly basis. Nevertheless, attempting to reconcile the quantitative estimates of Romer (1986) with a belief in the effectiveness of automatic stabilizers is not entirely... comfortable.

### "Structural" Deficits

There is an important argument that the belief in fiscal policy as a tool of economic stabilization has had harmful consequences for the economy as a whole. Buchanan and Wagner (1977) argue that deficits are very dangerous because voters are myopic: when spending is raised and taxes are raised to finance the extra government spending, voters feel both the pain of reduced after-tax incomes and the benefits of spending programs, and can judge whether the one is worth the other; when spending is raised and financed by borrowing, voters feel the benefits from spending but do not sense the true resource cost imposed by the higher future taxes (or the hyperinflation) required by the added indebtedness. The consequence? A government that is “too large,” in that in engages in spending programs that do not provide social benefits equal to their resource costs, and a heavier and heavier tax burden on future generations.




Democratic politics applied to government spending, Buchanan and Wagner (1977) argue, functions well only as long as deficits are effectively prohibited—regarded as extremely costly and as a dire moral evil. Arguments that deficit spending could be useful as a tool of stabilization policy managed, in Buchanan and Wagner’s view, to undermine the polity’s immune system that prevented the emergence of borrow-and-spend as a standard operating procedure of political parties. And the adoption of borrow-and-spend as a policy threatens to have evil consequences for economic growth: here in the United States we are still waiting for even the first sign of an endogenous rise in private savings to offset the fall in national wealth accumulation generated by the U.S.'s "structural" deficits.

It is hard to look back at the politics of America's federal deficit since 1980 without concluding that there is a good deal of truth in Buchanan and Wagner's argument. "Cyclical deficit—good. Structural deficit—bad" appears to be a message that is just a little bit too hard for official Washington to hold on to. And it is hard to believe that the alternative explanations for the emergence of structural deficits in the 1980s—primarily the necessity of slowing the preplanned growth of federal spending as a result of the slower growth of the real revenue base after the beginning of the post-1973 productivity slowdown (see Auerbach (1994))—are the entire story.

It is, however, a very malign fate that made the American political party usually seen as most sympathetic to Buchanan's general philosophy the carrier of the policies that he feared were the natural consequences of the use of fiscal policy for macroeconomic stabilization.

## Monetary Policy

Whether the fall in nominal monetary aggregates during the slide into the Great Depression best seen as a mistake of monetary *policy* (the failure of the Federal Reserve to shovel enough reserves into the system fast enough to keep the supply of money up) or as a shortfall in demand for money induced by the temporary collapse of the economy's financial intermediation "technology" under debt and deflation (as in

Bernanke (1994)) is an old argument. Would a marginally more-rapid expansion of the high-powered money stock have reduced the size of the Great Depression, or simply led to a marginally faster and larger decline in the deposit-reserves ratio? I am not confident that I know the answer.

I do, however, know that the same shifts in opinion and sentiment that made Congress announce in 1946 that macroeconomic stabilization was “the continuing responsibility and policy” of the federal government have also led the post-World War II Federal Reserve to—sometimes successfully, and sometimes not so successfully—make monetary policy with an eye not just on price stability but on a whole host of other factors as well. It is impossible to believe that we will see a repeat of the 1929-1933 experience, during which the Federal Reserve largely ignored the fall in monetary aggregates because it saw money and credit as “easy” in the sense that credit-worthy borrowers (of whom there were very few by 1933) could still borrow at very low *nominal* (but high real) rates of interest.

The adoption by the Federal Reserve of the mission of trying to keep unemployment from rising “too much” above its natural rate has had costs: it is difficult to believe that monetary policy carried out in the pre-World War II manner would have allowed the inflation of the 1970s. But even in the aftermath of the Volcker disinflation, the Federal Reserve continues to act as though bringing unemployment back down whenever it rises far above its natural rate is a high priority: in the most recent business cycle, the Federal Reserve pushed real short-term interest rates to and held them at *negative* levels from late 1991 until the beginning of 1994.

Here, too, the shift in the concerns and missions of economic policy makers signalled by the 1946 Employment Act continues to hold.

## III. Microeconomic Efficiency

In recent years, at least, macroeconomic policy management has not been the most time-consuming mission of the Council of Economic Advisers. Indeed, after one learns the hard lesson that the U.S. Congress and budget are simply no good at discretionary fiscal policy. it is hard to see much of a macroeconomic stabilization policy role for the Council of Economic Advisers.

The CEA communicates its own view of the economy to the Federal Reserve, with the hope of reducing the possibility that the somewhat insular Federal Reserve will talk itself into an erroneous picture of the economy. It attempts to communicate the Federal Reserve's view of the universe to the rest of the Administration. It attempts to persuade various Assistants to the President that Federal Reserve-bashing has significant costs and few benefits. It helps the President and his administration convince the press that they understand how the economy is working, and that the current administration's economic policies are in fact the appropriate ones. And it writes the annual *Economic Report of the President*.

But these tasks all together consume perhaps 70 senior staff and member person-months a year. The Council of Economic Advisers has some 180 senior staff and member person-months available.

The rest of the Council of Economic Advisers' time is spent on "microeconomic" issues, attempting to inject a sense of the public interest (sir, consumers aren't organized and demanding meetings with you every week, but they would be harmed by this policy); of the fact that the economy is an *equilibrium* system in which accounting identities hold (sir, if private savings remain anemic and the administration is lucky enough to see an investment-led recovery, we will see a sharply-rising trade deficit); and of the speed with which firms, workers, and consumers respond to incentives (yes, Mr. Magaziner, if a small low-wage firm pays $2,000 less for health coverage for a minimum wage worker than a large firm, you will see a lot of large firms fire their minimum-wage, and a lot of small firms hire such workers).

Often the Council of Economic Advisers gets flattened. To paraphrase one not-very-senior White House official, the public interest is just one more interest among many, and why should it deserve special consideration? To quote one ex-member of the Council of Economic Advisers, "in this business 0.250 is still a very, very good batting average." The logic of government is not allocative efficiency enforced by market discipline, or even optimal control. The logic of government is the logic of politics: power exercised, influence used, and reciprocal favors returned.

But sometimes the Council of Economic Advisers makes a microeconomic difference. And this may be its most significant contribution to economic welfare.

That the Council of Economic Advisers is able to make a positive contribution to the microeconomic efficiency of public policy is in large part the consequence of the staffing pattern established by Burns and Heller. Members and staff come from academic and think-tank positions, look forward to returning to academic positions, and view academic and think-tank researchers as the primary reference peer group whose approval they seek. Evelyn Waugh (1937) wrote of a tyrannical boss—Lord Beast—with whom people dared disagree only very gingerly: “Up to a point, Lord Beast.” Those who make a career of government are well aware that those in authority are rarely pleased by bad news, and find themselves under immense pressure to say “up to a point...” The Council of Economic Advisers is somewhat less likely to say “Up to a point,” when what is called for is “No! No! No!”

Perhaps this institutional capability to sometimes make a difference in terms of microeconomic efficiency is due to the operation of an Invisible Hand. Certainly it is not an outcome that anyone planned. Establishing in the White House staff a group of short-term employees with a primary allegiance to economists’ sense of the public interest may have been the furthest thing from the minds of those who wrote Section 4 of the 1946 Employment Act. Their goal was to reduce the freedom of action of the President and his staff by fixing responsibility for stabilization policy planning on identifiable individuals chosen with the consent of the Senate.

## IV. Conclusion: Hearts and Minds

John Adams wrote that the American Revolution was made not on the battlefield but in the hearts and minds of Americans. So the principal key to understanding the 1946 Employment Act is that it should be taken as a signal: a signal that henceforth an administration that failed to achieve acceptable macroeconomic performance was a failed administration.

What if there had been no 1946 Employment Act? One answer is that things would have been little different: the same pressures that led to the passage of the 1946 Employment Act would still have existed. Fiscal and monetary policy would still have been shaped with both eyes on macroeconomic performance. And there would probably have been an Employment Act of 1947, or 1948, or 1949.

A second answer is that there could have been no 1946 Employment Act only if the shifts in sentiment and opinion of which the 1946 Employment Act was a signal had not occurred, and if attitudes toward *laissez-faire* as a principle, toward government responsibility for the economy, and toward the likely effectiveness of government macroeconomic intervention in 1946 had been much more like attitudes in 1929.

A world in which opinion leaders and policy makers had not learned the lessons taught by the Great Depression and World War II would have been a very different world—presumably a world in which post-World War II macroeconomists called themselves Hayekians rather than Keynesians, discoursed on how deep recessions were a necessary price for the dynamic growth efficiencies of market-led economic development, and one in which governments responded depressions by cutting spending and raising tax rates to keep the budget in balance and so prevent investors from losing confidence and making the depression worse.

In such a world an outbreak of inflation like that seen in the 1970s would have been very unlikely. In such a world a repeat of the Great Depression would have been somewhat more likely.

I do not think that, on balance, many of us would think that it would have been a better world than the one in which we have lived for the past fifty years. But my opinion depends on a belief that the social and economic costs of the outbreak of inflation in the 1970s were low relative to the probability and cost of another episdoe like the Great Depression.

Yet a third answer is that in the absence of the *particular* institutional structure set up by the 1946 Employment Act, economists in government would have been fewer and less powerful. To some degree the then-Budget Bureau—now the Office of Management and Budget—and its director would have fulfilled missions now fulfilled by the Council of Economic Advisers: career civil servants in Executive Branch cabinet departments do refer to OMB and CEA as "sister agencies," and many times the Director of OMB has been drawn from the set of economists also on the natural short list for CEA chair.[6] But microeconomic efficiency as a goal of public policy would have played an even smaller and feebler role in economic policy making in the Executive Branch than it has over the past fifty years.

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[6] For example, think of George Shultz, Charles Schultze, or Alice Rivlin.

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