The Role and Responsibilities of the Economist in Government

Author(s): Charles L. Schultze

Source: *The American Economic Review*, May, 1982, Vol. 72, No. 2, Papers and Proceedings of the Ninety-Fourth Annual Meeting of the American Economic Association (May, 1982), pp. 62-66

Published by: American Economic Association

Stable URL: https://www.jstor.org/stable/1802304

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at https://about.jstor.org/terms

is collaborating with JSTOR to digitize, preserve and extend access to *The American Economic Review*

This content downloaded from 149.10.125.20 on Tue, 25 Jan 2022 17:56:06 UTC
All use subject to https://about.jstor.org/terms

IN HONOR OF ARTHUR OKUN

The Role and Responsibilities of the Economist in Government

By CHARLES L. SCHULTZE*

One oversimplified but nevertheless useful test to distinguish basic differences between "liberals" and "conservatives," conventionally defined, would be to ask a person to fill in the blanks in the following sentence with the words "long" or "short": "Look after the ______ run and the ______ run will take care of itself."

I contend that, with respect to matters of *microeconomic* policy and structure, most mainstream economists would fill the first blank with "long" and the second with "short." That choice is almost forced on someone trained in the basic body of microeconomic doctrine which holds that in the long run a decentralized price system, together with the signals and incentives it provides, does work to channel resources to their most productive uses. Where external costs or benefits exist, mainstream economics teaches that wherever transactions costs allow, internalization through the price system is presumptively (but rebuttably) the preferred way to deal with them.

I think George Stigler's observation, that economists by their very training tend to range themselves at the conservative end of the spectrum, is an accurate description when it is confined to microeconomic policy. In Democratic administrations, economist-advisers at the CEA, OMB, and Treasury can be counted on to take the negative position or support the low option when campaign promises about higher minimum wages come up for policy action. In Republican administrations, which seem particularly prone to export credit and maritime subsidies, economists in the same agencies can usually be counted on to advance the negative or low-option position.

A mainstream economist cannot fail to place major emphasis on the long-run efficacy of the price system to promote the national income and welfare. Moreover, unlike most of the people he works with in an administration, the economist has been trained to understand the complex ways in which the market system works to generate beneficial results and to recognize the roots of market failure when it occurs. There is a sharp contrast between the economists' world of finite elasticities and the legislators' and administrators' world of sharp corners and "requirements."

For this reason, I strongly believe that economists in government have a particular role to play in the area of micro policy, not merely as disinterested purveyors of technical advice, but as advocates. I am not merely offering the pious statement that the economist ought to favor efficiency. What I am saying is that in matters of specific micro policy, and within reasonable bounds, his role is to be the partisan advocate for efficiency *even when the result is significant income losses for particular groups*—which it almost always is. The equities at stake are not grand matters of progressive taxation, or welfare reform and the distribution of income by income class. Rather, distributional issues center on the inevitable losses in income suffered by some members of society—often rich and poor alike—as the result of choosing an efficient solution. It is the highly paid but less than infinitely mobile steel worker whose particular job must be balanced against the maintenance of free trade in steel. It is the Maine homeowner with an oil-fueled furnace whose spiraling heating costs must be balanced against the national efficiency gains from deregulated domestic oil prices. Even where it is a question of rescinding what were originally passed out as unfair privileges, the capitalization of subsidies into asset values has usually long since wiped out any advantages to current holders of the privilege, and a return to the *status quo*

*The Brookings Institution.

This content downloaded from
149.10.125.20 on Tue, 25 Jan 2022 17:56:06 UTC
All use subject to https://about.jstor.org/terms

ante will impose real losses on presently protected groups.

In another vein, techniques to achieve social goals through incentives (i.e., pollution fees or permit auctions) are blind to equities. At least in the short run, the current approach under which EPA or OSHA negotiate the application of regulations on a case-by-case basis seem to allow greater leeway to soften individual hardships.

The economist turned policy adviser will come upon few completely Pareto-superior possibilities during his tenure in office. In matters of specific micro policy, an efficient system of compensation finely tuned to the incidence of the losses is, by definition, impossible. Hence micro-policy decisions almost always present a tradeoff of overall efficiency against losses concentrated among specific groups.

While it is exceedingly important that the economist's emphasis on efficient, and wherever possible, market-oriented solutions be vigorously represented in the advocacy process by which policy is formulated, it is not the only legitimate point of view.

First, and most obviously, our own training should remind us that there is no objective way to compare large losses concentrated among a few with small losses dispersed among the many. In economics, as in political science, solutions to the problems of tradeoffs between minority rights and majority costs are not always self-evident. There is good reason for our bias towards efficient solutions—but it is not an absolute criterion. Other points of view are legitimate.

Second, there is the matter of market failure. Our political system appears to be strongly biased against the use of market-like mechanisms and incentives, and highly biased towards regulatory approaches to market failure. But it is also true that without extensive knowledge of a particular industry or sector, economists are sometimes prone to apply market principles in too simple a manner, and to underestimate the problems generated by specific institutional circumstances. Threading one's way through the thicket of the economics of medical care is a chastening experience *both* for those who would regulate everything *and* for those who would let the market solve all problems. To be admitted as a full-fledged member of the political process, in the very necessary role of an advocate for market-like solutions, the economist must recognize the legitimacy of other advocacy roles.

And, finally, the economist in government must recognize that in formulating any public policy there are political opportunity costs to be considered equally as real and as important as economic opportunity costs. To the economist, a decision on how best to reform program A can be made in terms of the national benefits and costs of program A. But to the Cabinet officer or White House political adviser, the political "cost" of reforming program A may be defeat of reform in program B. The calculus of consensus has many of the same formal rules as the calculus of welfare maximization. Those who engage in the latter cannot afford to look down on those who practice the former.

I. The World of Macro Policy

As we are all painfully aware, the loose consensus among mainline economists on major elements of micro policy breaks down when it comes to macro policy. One large group would continue to fill in the blanks of my test question so as to emphasize the overriding importance of long run structural considerations. Get the money supply "right" and keep it "right" and the short run will indeed take care of itself, at least to the extent that it cannot be bettered by discretionary macroeconomic policy. But another large group, if forced to choose, would fill in the blanks the other way around, on grounds that the short run will not take care of itself. (They would of course protest about having to choose, saying that the long run was also important.)

Views about how the market works in the *short run* tends to divide economists on macro issues, just as views about the *long run* working of the market unites them on micro issues. Those who believe that there are powerful forces moving prices in a market-clearing direction, sidetracked principally by surprises in policy behavior, will emphasize the importance of putting in place stable and

This content downloaded from
149.10.125.20 on Tue, 25 Jan 2022 17:56:06 UTC
All use subject to https://about.jstor.org/terms

credible long-run macro policies. They give primacy to anti-inflation over employment supporting objectives because they believe that except in the short run, there is no tradeoff. (Even in this view, however, there is one circumstance under which the medium-term employment costs of price stability may become large, and that is during the return to price stability after a long period of systematically inflationary policy. It will then take time for a new anti-inflation policy to gain credibility.)

Economists of this persuasion are usually bound together by several other views about the nature of the economy, views which strengthen their preference for a noninterventionist macro policy. They tend to see the demand for money as relatively stable and so believe a steady path of monetary growth will be accompanied by a stable path for nominal *GNP*. And they are also inclined to believe that most major disturbances to the "real" economy have stemmed from misguided government policies.

Those who read the evidence in a different manner, as confirming the inherent stickiness of wages and prices, necessarily come to quite different judgements about macro policy. Market-clearing forces act very slowly to reconcile price stability and high-employment objectives. In the meantime, there *is* a difficult tradeoff problem; the employment costs of reducing a large inherited inflation or suppressing the inflationary consequences of an aggregate supply shock are very substantial. Since, in the short and intermediate run, markets do not clear in expected prices, macro policy can systematically be used to support unemployment, albeit imperfectly and at some inflation cost.

Economists who have only limited faith in the ability of market-clearing forces to stabilize the macro economy are also less likely to believe in a stable demand function for money, and more likely to emphasize the potential for fluctuations in real aggregate demand and the damage that can be done by aggregate supply shocks. These views contribute further to their belief that discretionary macro policies are at times likely to be needed.

Most economists, of course, position themselves not at the polar extremes of any of the dimensions I have identified, but somewhere along the interior portion of the spectrum.

Economists differ not only over the extent and shape of the tradeoff among differing macroeconomic goals but, for the bulk of them who agree that some tradeoff does exist, over the normative importance they attach to each of various goals: How much weight should be given to short- and intermediate-run employment objectives versus long-run inflation objectives? Do incomes policies promise to improve the inflation-unemployment tradeoff sufficiently to warrant their micro economic costs?

Differences in both analysis and value judgement make it impossible to identify an "economist's" position in macroeconomic policy that can be defined in distinction to the typical "noneconomist's" position. And so there is no general guideline for the behavior of the macroeconomist in government, equivalent to the "advocate for efficiency" role I have suggested for micro policy. But there are a few observations about the art of giving macroeconomic advice that may be useful to economists of all but the most extreme persuasion.

The disarray within the profession on matters of macroeconomic theory and the disappointing economic performance of the past decade—under administrations and economic advisers of various hues—would seem to provide grounds for humility on the part of economists when they give macroeconomic advice. Certainly the public strongly believes that humility is called for. And I surely do not want to promote the virtues of arrogance. In fact, however, great humility and diffidence in an economic adviser is not an attribute that will contribute to his effectiveness, nor is it in fact warranted.

An economist who is still so uncertain about how the world works that he cannot choose among widely differing points of view ought not to be an economic adviser. And, having made this basic choice, the economist has less reason to be humble about the validity of his economic recommendations than the ex-businessmen, bankers, lawyers, and

This content downloaded from
149.10.125.20 on Tue, 25 Jan 2022 17:56:06 UTC
All use subject to https://about.jstor.org/terms

politicians who will constitute the other players from whom the president will receive economic advice. The macroeconomic views of the business, legal, finance, and political professions are surely not noted for either their unity or their forecasting track records. Moreover, the economist, from whatever school, is likely to have a coherent view of how the economic world operates, and is more likely to perceive when proposals are inconsistent with each other or with the overall economic approach of the administration in which he serves. And so, while the economic adviser should be very conscious of the huge uncertainties within which macroeconomic policy must operate, the lack of professional unity on the subject should be no cause for him to mute or overqualify his views in the policy debate.

There are, however, two temptations to the macroeconomic policy adviser that, in my judgement, are particulary insidious. There are difficult choices to be made in deciding how large are the employment costs that should be paid in using demand restraint to bring down an inherited inflation or to suppress the inflationary results of an aggregate supply shock. And even in the midst of a recession, actions to speed the recovery have a cost in terms of reduced anti-inflationary gains from economic slack. Having chosen—on both economic and social grounds—a preferred course of action, there is always the temptation, in the heat of internal policy debate, to minimize those costs. This is a temptation strongly to be avoided. It does not serve the policymaker or the public well when economic advisers fail to disclose the inevitable tradeoff costs of a proposed macroeconomic policy action.

Similarly to be avoided, in my judgement, is the futile effort to manipulate psychology or expectations by means other than solid policy. While it is undoubtedly correct that expectations are an important determinant of outcomes, that they are often quite volatile, and that the success of an economic policy sometimes depends on a change in expectations, that fact must be handled with great care. There is a strong strain among political advisers to believe that expectations can be successfully manipulated independent of policy content and that policies can have "real" and expectational consequences at variance with each other. Self-professed experts confidently predict the "announcement" effects of a policy statement. Changes in budget deficits are sometimes split into two parts: a real change which is thought to be small and a "Wall Street" effect which is said to be large. Great effort is expended on how a series of economic decisions is to be "packaged."

Some of this is harmless (though time consuming). But an economic adviser who begins to take these games too seriously is in danger of trading all his acquired knowledge about economic interactions for a mess of psychological pottage.

The economist turned policy adviser will quickly discover that in the councils where economic advice for the policymaker is formulated, one-half to two-thirds of the discussion has little to do with economics at least in the conventionally defined sense. A large part of the discussion centers around political feasibilities, legislative strategy, optimum timing, effects on public opinion or on one of the other groups in an administration's constitutency, scheduling and carrying out consultation with congressional leaders, consistency (real or imagined) with past policy or promises, and so forth. Matters of jurisdiction and "turf" sometimes occupy a great deal of attention and are often quite important in the outcome of economic policy. (Economists interested in minimizing protectionist measures, for example, should tenaciously block efforts to shift the locus of decisions on trade matters to the Department of Commerce which is inevitably protectionist minded.)

In this environment, the economic adviser must walk a careful line to avoid two opposing dangers, especially where political matters are concerned. The danger of the economist trying to act as a political expert is not so much that he is likely to be a poor one, but that he may too easily slip into the (unconscious) habit of rationalizing his political judgements with economic arguments and vice-versa. At the same time, however, dis-

This content downloaded from
149.10.125.20 on Tue, 25 Jan 2022 17:56:06 UTC
All use subject to https://about.jstor.org/terms

cussion of economic policy is seldom neatly segmented into economic and political slices. And much of the political discussion will involve not so much a simple "yes" or "no" judgement as to political feasibility, but a weighing of the economic costs of the numerous bargaining concessions needed to secure enactment of a program. The politics and the economics become inextricably mixed. The economist cannot sit mute while this weighing of costs and benefits goes on. Moreover, as Herbert Stein has pointed out, most political discussions are based on very casual empiricism. Some people are quite good at it. But it doesn't come with the territory; many policy advisers, who pride themselves on their political acumen in fact do miserably at predicting political reactions or outcomes. Moreover, it is not uncommon for cabinet officers and presidential assistants to discover political dangers looming behind policies which they already oppose on substantive or bureaucratic grounds.

On balance, then, the economic adviser should vigorously participate in the whole gamut of policy debate, but should never lose sight of the prime reason for being there —to give professional economic advice, not watered down in advance by his own political judgement. In practice this usually comes down to a matter of emphasis. The extent and force with which an economic adviser pushes his own political judgement in the policy debate ought to fall substantially short of the extent to which he insists upon his economic judgements.

This content downloaded from
149.10.125.20 on Tue, 25 Jan 2022 17:56:06 UTC
All use subject to https://about.jstor.org/terms