APPRAISAL: NATIONAL POLICIES FOR FULL EMPLOYMENT

by Oswald H. Brownlee

There are relatively few points in Dr. Preston's presentation with which I disagree. I assume that his summary of the administration's fiscal policy is correct, although the President's talk in New York December 14 suggests that future policy is somewhat ambiguous. Cutting taxes and expenditures by equal amounts will not stimulate demand in the economy.

I agree with Preston that the government has no employment policy, but unlike him I consider this to be a good thing. I believe that it is appropriate for government to try to achieve an equilibrium value for gross national product such that if money wages do not rise faster than labor productivity, unemployment would not exceed a given figure. But to do more than this could involve government in wage and price controls or in support programs for many commodities -- not just agricultural ones. This can be very costly in terms of economic efficiency.

However, in the context of what ought to be done in the current situation, this difference in our points of view is not important. We agree that the current gross national product is too low -- by $30 to $35 billion at an annual rate -- and that any substantial increase is highly unlikely without government actions that differ from those of the past two years. The economy is lethargic because of government rather than in spite of government.

First of all, federal cash payments to the public and receipts from the public would be about equal at a gross national product not very much larger than that which we will have during the fourth quarter of 1962. At levels of gross national product above that at which the budget balances, the fiscal system exerts a "drag" on the economy from a fiscal standpoint. Thus the present gross national product isn't very different from the equilibrium one.

Secondly, until very recently there has been very little increase in the money supply during 1962. Within the past few months reserve requirements for time deposits of commercial banks were reduced, thereby increasing total reserves and the money supply. This change was made to reduce the competitive disadvantage of commercial banks in bidding for savings accounts rather than as an expansionary measure. But its impact is in the right direction. With the exception of this change, the other expansionary actions have been temporary. Liberalization of depreciation allowances changes in the time pattern of tax receipts -- not the total tax liability -- and the tax credit for new investment will not be a permanent feature of the tax system. (we hope!)

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There are many ways by which the equilibrium value for gross national product can be increased by government. A cash budget deficit of $10 billion at a gross national product of $560 billion eventually would raise the GNP to about $590 billion. If it were achieved by cutting taxes, interest rates would rise and consumption would be encouraged relative to business investment. If the deficit were brought about by increased governmental spending, interest rates would also rise and the governmental sector would be pushed somewhat at the expense of investment. (In both cases it is assumed that the deficit is accompanied by increased interest bearing government debt.) The budget could be left untouched and the money supply increased with a consequent reduction in interest rates and encouragement of business investment.

Increasing the money supply as a means of encouraging economic expansion has been considered "out" because of our balance of payments problem. It is believed that either we must reduce drastically foreign aid (including military procurement abroad) or maintain high interest rates or devalue -- a possibility which usually will not be discussed. Consequently, the budget must be our expansionary vehicle.

Personal tax reduction is not popular with everyone as a means for getting a budget deficit. It means pushing consumption relative to investment, and investment is held to be the key to economic growth. I am not one of those who believes in economic growth for its own sake. However, if it is desirable, the increased saving required to provide the additional investment for, say, a growth rate of 4 percent per year rather than 3 percent is large. If the elasticity of output with respect to the stock of capital is one-third, the capital stock is three times income and saving is 9 percent of income, the saving rate must be doubled to achieve the required growth rate increase through investment. In my view, elimination of certain resource misallocations brought about by restrictive labor practices, the agricultural program and mandatory retirement at a given age, for example, would be much more effective.

Tax reduction, however, could be tailored primarily toward increasing investment. This would mean such things as cutting business rather than personal taxes and substituting an expenditures tax for personal income taxation. Neither step is likely to be acceptable because of its expected impact upon the income distribution.

In summary, a tax cut can raise the gross national product. Such a cut should be made to increase demand without mixing this objective with tax reform or steps to promote economic growth. These other factors can be taken into account later. Packaging them with the needed expansion may result in no action.