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ARTHUR OKUN ORAL HISTORY, INTERVIEW I
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INTERVIEW I

DATE: March 20, 1969

INTERVIEWEE: ARTHUR M. OKUN

INTERVIEWER: DAVID McCOMB

Tape 1 of 1

M: This is an interview with Dr. Arthur M. Okun, who is the former Chairman of the Council of Economic Advisers. I am in his office now in Brookings Institution in Washington, D.C. The date is March 20, 1969; the time is 2:50 in the afternoon; and my name is David McComb.

First of all, I'd like to know something about your background, where were you born, when, where did you get your education.

O: I was born in Jersey City, New Jersey, on November 28, 1928. I was brought up most of my life in Passaic, New Jersey; went to public schools there and met my wife there. Then I did my undergraduate and graduate work both at Columbia in New York City. In 1952 I went to Yale as an instructor, and that was my job until coming to Washington--as an instructor, assistant professor.

M: You first went to Yale in 1952?

O: Right. It was really my first job out of graduate school. My first venture into government service was in 1961 when James Tobin of Yale became a member of the Council of Economic Advisers. He introduced me to Walter Heller, who was then Chairman. Jim and I had been close friends and colleagues at Yale, and we made an arrangement whereby I was a consultant for the Council between January and June of 1961. I earned my first pay check on Inauguration Day. I spent typically Thursday and Friday down in Washington during that period, and then meanwhile was teaching school back at Yale. As a matter of fact, I picked up one of Tobin's courses that he had to drop, so it was a pretty active period for me.

Then at that point, I became a member of the Council staff, and I was on leave from Yale in the '61-'62 academic year. I spent fourteen months working for Walter and Jim Tobin and Kermit Gordon with the other members of the Council at that time; and I was on the staff doing work primarily in forecasting and fiscal policy, which were my academic specialties.

In September of '62 I returned to Yale and continued to have a consulting involvement, but a much smaller involvement, in the Council for the next two years. I thought I had returned to the academic life. We traded up houses in New Haven in 1963 and then in June '64, to my surprise, Walter called me and asked whether I would consider becoming a member of the Council when he left. He was then planning to leave as soon as the president would let him go. I think he said it was already definite that Gardner Ackley was to be his successor, and hence there would be a vacancy on the Council, which he was asking about my interest in filling. That brought me down--

M: Did you have an interview with White House staff people or with the President?

O: At the time of my appointment, no. In fact, I met the President for the first time--I know I saw him when he was Vice President in '61-'62, but I met him really personally for the first time in August of '64. Actually, Walter sort-of transmitted the invitation for the appointment. I met the President--at that time I was on the task force to study stabilization programs--fiscal monetary policy.

M: Was this a 1964 task force?

O: That's right.

M: That was the one when he was putting together his program.

O: Right. And I actually, really because of the academic year and my kids in school and all of that, came down to Washington in September of '64, and I was on the staff of the Council for the next two or three months. But this was all in contemplation of the elevation to membership on the Council. Then on November 16, '64, Gardner became Chairman, and I became a member of the Council.

M: That's a picture of you and the President and your wife and three boys.

O: On November 16, '64, when I had just been sworn in as a member of CEA.

M: This 1964 task force that you were on, who else was on that task force?

O: It was chaired by Joe Pechman, as I recall. No, I'm sorry. That was the one that was chaired by Paul Samuelson. And Locke Anderson,who was on the CEA staff at the time, worked as executive secretary.

M: Were the ideas from your task force fairly well received?

O: Yes. I think at the time there was still a concern of the task force about the need for additional stimulus--you know, continuing to invigorate the economy. Within a year that situation changed pretty drastically, and ever since we've been worrying more about how to feed the economy sedatives than stimulants. So, to that extent, events made economic thinking of 1964 rather obsolete. But I think some of the basic ideas of the task force continued on. The task force emphasized the need for prompt action on fiscal policy. We've had lots of examples of that in recent years, have urged strongly the proposal for giving the President some discretionary authority on tax rates, and that's an issue wherein the battle is still to be fought. It appeals to everybody except Congress.

M: Let me ask you a little bit about the mechanics of the Council of Economic Advisers, how it operates. When Gardner Ackley was the Chairman would you divide up the workload among yourselves or what?

O: The way it operated, both when Gardner was Chairman and when I was Chairman--

and pretty much the same way when Walter was Chairman--the world got divided essentially in half. And each of the two members other than the Chairman took half of the subjects and topic areas and assumed a responsibility for them. The rationale was that the Chairman had to worry about everything, and in some ways didn't take direct responsibility for anything in a substantive area. Obviously, that left the Chairman free to freelance on whatever happened to be the biggest flap of the moment and also left him for what was his major distinguishing job, which is that of being the real liaison of the Council with the White House and indeed with the President himself. Obviously, the Chairman did work and does work with the members of the staff, but the staff people will see the two members of the Council a good deal more than they will see the Chairman.

M: Did you specialize with one member--?

O: Yes.

M: --getting into one area and the other in another?

O: Yes. I could go into this in some detail. When I became a member of the Council, Otto Eckstein was the other member. I was responsible for forecasting and sort of overall fiscal policy and the whole money financial area and the international area. Otto took responsibility for wages and prices and most of what we call microeconomics, all the particular program areas ranging from Social Security to stockpiles and coordination with the Budget Bureau on program decisions. He also had a responsibility for sort-of the tax structure, tax reform area as opposed to the overall fiscal policy. Then when Jim Duesenberry came in in February of '66, we did a little shifting. Jim's specialty was in the money area, and I gave up the monetary--financial side of things, handed that to him, and took on the tax structure in some of the microeconomic areas, although he continued to do wages and prices, and most of the micro-areas that had been Otto's.

M: Where would the initiative for a study arise? Would a problem come over, say, from the President or from the White House staff, or would you foresee problems and work on them, or just where did the initiative of your work come from?

O: Oh, it would come from any direction--internally generated or generated from the White House. It's hard to define. Let's see if we can break it into blocs. One bloc of work was associated with some continuing interagency groups. Probably the most important of these, at least in my experience personally, was the Troika--the three agency group, Treasury, Council, Budget Bureau, that were responsible for keeping the President informed and advised on overall economic conditions and the budgetary outlook, both expenditures and receipts. The Troika not only was a three agency body, but a three level body as well. The staff level, called the middle Troika, which was a member of the Council and Assistant Director of the Budget and Assistant Secretary of the Treasury; and then the heads of the agencies would form the top Troika. I guess I have hold of the notable distinction of being the only man who ever served on three levels of the Troika. In '61-'62 I was on the staff level, and '64 into '68 I was middle level, and then became a top Troika man in '68-'69.

The Troika was really a Kennedy Administration innovation. I think it was a very important innovation because it put things on a regular review basis, which had never been done before. There was a coordinated effort to deal with some of these same issues and same problems under the Eisenhower Administration, but it was sort of an ad hoc affair that when the budget had to be formulated, they met; when there was a flap, when somebody would raise questions about "should we be cutting taxes" or so, they'd hold a meeting, and they'd do a memo, and such. Here we had a procedure that assured that the President got at least a quarterly review regularly of what was new in the economy, whether there was any need to change the estimates of economic activity, employment, prices, gross national product, what had been carried in the budget or in the last Troika memo, whether budget expenditures were outrunning the estimates, whether receipts were coming in stronger or weaker than had been anticipated. This forced all of us right from the staff level on up through the principal, indeed right up to the President, to focus at least that often on the fiscal policy question. And it also became a forum whereby you'd get a lot of contact and a lot of intervening discussion among the various Troika people on how they saw the fiscal policy side of things. I think this turned it from a fire alarm system into a continuing watch, and I think it was really an institutional reform that fitted what I think was the key element in the whole of the New Economics which was a shift of fiscal policy from meeting problems to trying to plan and program and sustain prosperity for the country. We didn't just wait for a sign of recession and boom, and then say, "What shall we do about it?" We tried to think all of the time, and on a regular basis, "How is the budget meeting the needs of the economy and to what extent are alterations in order?" I'm not saying we always answered these questions correctly, but we were asking the right questions, and I think that made a lot of difference.

M: Who originated this Troika idea?

O: I'm not sure I know exactly how it evolved. I think one unsung hero in the process is a staff man of the Budget Bureau, Sam Cohn, who had suffered through the Eisenhower years--in his own words--and really was looking forward to an opportunity to do something with the fiscal policy front--and a very able guy, one of the top civil servants in the economic side of government. Dave Lusher of the CEA staff, another veteran, I think also presented the diagnosis that led to much of this. This was initially really worked out and negotiated between Walter Heller and Dave Bell and Doug Dillon. The thing evolved to a degree where I would say there were really no basic organizational or institutional changes in it from the time of its initial conception in the spring of '61.

M:: It never did become a statutory group then.

O: Oh, no.

M: It was more informal than that.

O: Yes, much more informal than that--no Executive Order, no separate line in the budget. Basically the people who were covering these areas in the agencies in any case were coordinating and developing this, but it became a recognized institution within the operations of the Executive Branch. The President knew what he was getting when he was getting a Troika memo, and he knew roughly when it was coming. Obviously the Troika label came from the fact that it was a three-agency body.

M: Would you send him memos at your discretion, or was this regularized in any way?

O: Basically there was a schedule which the people departed from, but it did serve as a point of departure, as a benchmark. Each quarter you get around the middle of the third month of the quarter, the first guess that the Department of Commerce can make on the quarterly GNP. In other words, they would have made that last week for the first quarter of this year. They've got two months of figures in pretty well; they can begin to see what's shaping up for the quarter; and this is something which is for internal use only. Usually it was at that time that the staff would get together, and they'd look at these figures and they'd say, "Okay, here's where we thought this would come out a month ago," and they'd have essentially a comparison of a very preliminary and tentative, you might say, guess at the actual results of the quarter compared with their prediction of a quarter earlier. Along with that, the Budget Bureau would bring in what information it had about changing course of federal expenditures based on uncontrollable programs moving faster or slower than they had expected, based on changes in congressional action from what had been implied or recommended in the President's budget or what had been guessed internally previously. The Treasury would bring in its judgments on how revenues were going. So you really did have, at least initially, a kind of division of labor, Budget having primary responsibility for the expenditure projections and estimates, the Treasury for revenue projects and estimates, and the Council for economic activity assessment.

But obviously any staff works together, and people looked over one another's shoulders, and at times when people would raise questions about whether the Council's estimates of economic activity were the ones that ought to be used. Indeed, over time Treasury pretty well developed its own staff capability in there, and it came to be a negotiation, much the same way the Council would second-guess the Treasury's revenue estimates. Everybody would, particularly once Defense spending started jumping around, start second-guessing the Budget Bureau's expenditure estimates. But then you'd get a week or so of this effort at the staff level which usually resulted in a single consensus reestimate after some negotiation. These things develop informally. People recognize that they don't report to their superiors if they're a half-billion dollars off in estimating gross national product. They find some way of compromising the difference.

If there were major differences of opinion on the part of staffs representing the different agencies, or individual staff members--I don't think they went into these necessarily feeling that they were representatives in an agency position. They were there as experts, and there was a good deal of academic freedom in feeling that these people were there to call the shots as they saw them, and to report on how they saw them. That would mean that the middle level might feel that if they didn't agree with the staff, they didn't accept their estimates; they'd want to modify them in some way, or go at the principals' level. Usually at the middle level when they reviewed the technical estimates, you'd get somebody drafting a memo designed for the principal or for the President, trying to summarize these in a way of bringing out the highlights and indicating where the major surprises or implications for policy were.

To the extent that during the year, March or June or September, you'd have any very substantial shift from the preceding quarter, there might be attempts to show what would happen if you altered the policy. If you went in for a tax bill, if you cut expenditures or raised expenditures--sometimes when we knew we were in major doubt about the outcome of a piece of legislation which would have big implications for the budget and the economy, we'd have alternative models saying, "Okay, if Congress does it this way, here's what we expect; if Congress does it that way, here's what we expect."

The President would get this memo ultimately, and often it was associated with a meeting with the President which got attended, typically, by just the principals, occasionally the middle-level Troika invited along. Sometimes if no one thought there was a need to take the President's scarce time with meetings, you'd just give him the memo. This was an application of the general rule that you could count on the President doing his homework.

He responded very well to written briefing information.

M: Within the Troika, did you have any difficulty explaining or in effect selling economic ideas to the Treasury people?

O: Not really. I think there were differences of a significant sort in 1961 and into 1962. There's no question that from the outset Dillon and Heller were giving President Kennedy quite different advice. I think after that--

M: Can you explain the difference?

O: Yes, sure. The economist's diagnosis of the ills of the economy right at the start in 1961 was that it had been over-sedated with an excessively restrictive budget, which had so sapped its strength that you weren't getting the revenues from that budget; and therefore the budget looked as though it wasn't restrictive. Still you had a deficit, but the deficit was associated with trying to get too big a surplus and therefore holding down incomes and profits to the point where the revenues weren't coming in. We developed a concept called the "full employment surplus" of trying to show where the budget would be if the economy was on a high employment growth path and trying to show that basically you had a much too tight budget, and that from the economist's point of view the right medicine was one of a more stimulative budget which would bring the economy to full employment, reduce unemployment, strengthen investment, give us a lot more output for which there were and remain very urgent uses. Obviously, this would mean in the short run that you'd have to do things which would make the budgetary deficit a lot bigger.

Now, we argued, and I think the facts proved ultimately that there was a good deal of merit in this, that if you did the right thing in terms of either more government spending or a tax reduction of major proportions, that you'd invigorate the economy enough so that incomes would be much higher and therefore you'd get higher revenues as a result of those higher incomes, enough to offset this, that at least the large deficit that would be incurred would be a transitory phenomenon. There were some rhetorical statements made about how you could balance the budget by stimulus and so forth. I'm not sure one could ever demonstrate that indeed you collected more than you gave away, but at least you got a very major offset to this. I think the chief constraint to rational overall economic policy in 1961 was the vehemence of the commitment to balance budgets; the notion of budgetary deficits as sin had prevailed and been strengthened during the 1950's.

M: Did this feeling prevail in the Treasury department at the time?

O: No, I don't think it was anywhere nearly--it wasn't shared initially by the Treasury. But Treasury took the view that while there were good arguments for priming the pump with an anti-recession recovery program that was designed to meet the particular weakness of early 1961, that the case hadn't been made for a more sustained program of economic stimulus. And I think the Treasury was very sensitive to the feelings that there might be adverse reactions by foreign central banks and the international financial community to a program of economic stimulus, that this might hurt our balance of payments unduly in their view.

M: This was Dillon's position?

O: Yes. I don't mean to caricature these things, and I am caricaturing them. This was a difference of degree, but it was a pretty big difference of degree, and it came up in several very specific ways. I remember President Kennedy had been unwilling to really take issue strongly with the balanced budget idealogy in early '61. Indeed he had run on a platform in which he had sharply criticized Eisenhower for the big deficit of fiscal '59. Many of the early efforts to get some stimulus into the economy were coupled with rhetoric that really was pretty low-grade by a professional standard. Oh, there was a wonderful passage we used to call the "Seven Escape Hatch Clause" in an early Kennedy economic message which said, "The program I am now proposing will balance the budget provided that, a, b, c, d--" all of these things were purely untenable provisions. But there was a feeling of a political need to pay lip service to this orthodox creed.

This came up again in July '61, which perhaps was Walter Heller's first very major substantive victory on the fiscal policy front. There was this Berlin crisis add-on to the Defense budget at that time, and a great deal of advice was being given to the President to couple that with a proposal to raise taxes at a time when the economy was practically flat on its back, with a 6-percent unemployment rate. There wasn't the slightest economic danger of adding that small amount to Defense spending at the time. It was rather amusing. Much of the support and enthusiasm for this tax proposal came from people who were making national security policy and thought that it would be great to show that we care so much about Berlin that we're ready to raise taxes for it. And I think some of the political types in the White House saw this as the first opportunity to implement the "sacrifice" theme that had been so important in Kennedy's campaign. You know, he told people they had to ask what they could do for the country. He hadn't told them what they could do for the country, but they could pay higher taxes. It took quite a battle on the part of the Council to stand up and say, "The people who would be making the sacrifice here are the people who would be unemployed," and those weren't quite the people whom we wanted to apply the sacrifice to. This kind of masochistic display wasn't going to convince the Russians or anybody else. It was just going to weaken the economy.

As I recall--this is a story I know only second and third-hand--but until a few hours before Kennedy went on television to make his proposal, there were two drafts of the speech, one of which had the tax increase in it and one of which did not.

M: So he was not really convinced right up to that point?

O: I'm not sure that he'd ever, up to that point, been confronted hard with the issue. As I understand it, the afternoon of that speech he focused on the economic aspect of this Berlin decision, and Sorenson, who was drafting the thing had drafted it both ways. Then he went along with the CEA advice.

I don't think Treasury took a particularly strong stand in favor of the tax increase. What Dillon did do, which had very important implications for a subsequent economic policy, was to urge the President strongly to couple this increase in the fiscal '62 deficit with a promise to balance the budget for fiscal '63 that would be proposed in January of '63. This wording was put into that late July '61 message. And it became an albatross subsequently because we clearly wanted a deficit for fiscal '63 on economic grounds.

An amusing incident that I recall hearing about--President Kennedy made some statements that seemed to be wiggling off the hook of this balanced budget commitment at a press conference in August or September '61. Dillon called him the next day and told him that we'd upset foreign bankers and urged him to clarify what he meant and reaffirm his determination. Walter, who had been delighted by the President's ability to see this more pragmatically, was told that Kennedy felt he had to do this, that he did indeed reaffirm that and that there was a balanced proposal in the fiscal '63 budget, which never materialized at all.

I think the key manifestation of Kennedy's conversion to the Heller creed was the commencement address that Kennedy gave at Yale in June 1962, which was something--he really wanted to do this. And it was clear--again operating on other people's stories--he wanted a myth-exploding speech, and he ordered that it be focused on economic policy. He really went after the balanced budget myth as the key myth that needed to be destroyed.

During that period there was a good deal of discussion over whether there could be a quick tax cut legislated in the summer of 1962 at a time that the economy was slowing down. There was a real effort by the Council to convince the President that that would be an appropriate recommendation, and he concluded that it was politically unfeasible. It got labeled a "quickie tax cut," and, boy, that killed it! Congress never wants a "quickie" anything.

But when Kennedy announced his decision on that, he did say publicly that he was going to go for a major tax reduction bill in January 1963, and indeed he did. As you know, that didn't get enacted during 1963; and it was really the first item on President Johnson's agenda, and perhaps his first major legislative victory. It got passed on February 19, 1964. When, after a few months of skepticism and mixed returns, it became clear that the economy had been very substantially invigorated by this--I suppose the time I came to Washington in the fall of '64 the economists were riding about as high a crest of esteem and respect for the success of the tax cut as has ever been achieved.

M: It would seem that Walter Heller had a major task, in effect, educating John F. Kennedy about this. How did Heller go about educating a President? What does he do? Does he send him memos, talk to him on occasion?

O: Yes. I don't really know just how much of what kind of communication there was between Heller and President Kennedy. I know there was a flood of paper that went from the Council to the White House. Even after Kennedy was personally sold there was a further educational problem of convincing the public and convincing the Congress. I know at one point Heller essentially got the President's permission to run in advance of policy making and go out and make the case publicly before the President actually signed on to a stimulative fiscal policy. Heller did a great job of public education. He got a lot of press attention to the whole fiscal policy arena and to the possibilities of prosperity; to try to popularize a notion that an underemployed economy was a great national waste. One of my first tasks on the Council was to try and estimate what our potential was. That estimate of potential output I guess remains my best known professional contribution as an economist. It's widely referred to as "Oken's Law."

M: This was when you first became a Kennedy consultant?

O: Yes.

M: In the early '60's?

O: In early '61, I worked on "Okun's Law."

M: Is "Okun's Law" still valid?

O: I'm always amazed. It has no right to hold as well as it does. It wiggles off now and then, but it's a law that's violated only in the second decimal place. It's a very shorthand approximation to a bunch of complicated relationships, and says essentially that you lose roughly three percent of the potential output for each one percentage point extra unemployment that you sustain. And that three-to-one relationship holds pretty well.

M: Did you also struggle in this early '60's period with the phenomena of "Phillips' Curve" and the inflation versus the unemployment?

O: Obviously, the inflation problem was always there, but it was more of a nightmare than a reality. It was an additional reason that conservatives had for opposing expansionary economic policy. It didn't have great popular impact at the time because there wasn't any very evident inflationary experience or imminent threat at a time like that.

There were a couple of things. I think the Council really conceived of the inflationary threat that would be posed as the economy began to recover in a way that perhaps fitted the mold of the mid-50's, where we'd run into most of our problems in the area of concentrated industry and big labor. Steel had been the bellwether of the 1955, '56, '57 inflation. I think much of that thinking of the fear of a repetition of the mid-'50's experience influenced the whole formulation of the guideposts by the Council in late '61--appeared for the first time in the January '62 report. That wasn't an area that I was directly involved in to a great extent at that time, although there would be staff meetings and broader groups and so forth where I would get into it to a degree. And, as you know, there was the big confrontation between the steel industry and President Kennedy in April 1962, which really was the first threat of that kind of an inflationary pressure coming out of a concentrated sector of the economy. The whole guideposts area was thus one major concern, one activity of the Council in trying to head off that type of inflationary threat--and also in evincing a clear public image of our concern with the price level problem, basically saying that the way to deal with the problem in a world of 6 or 7 percent unemployment was not to keep the economy flat on its back, but rather to deal with what seemed to be the key area of threat to price stability.

The other thing which was a very powerful force in the early '60's was this so-called structural unemployment thesis that really was linked to the inflation argument. The argument was that somehow the demands and requirements of the labor force had changed in such a dramatic way that whereas it might have been possible in the mid-'50's or in the '40's to have 4 percent unemployment without extreme bottlenecks and pressures, that you couldn't do it again because you just had a lot of labor that wasn't employable, wasn't ready to meet the needs of modern industry and so forth; and therefore the economy <u>really</u> was more fully employed than it looked by judging from the unemployment numbers; and therefore you'd run into inflation rather than increases in production and employment a lot faster if you just tried to stimulate the economy through traditional fiscal and monetary policy tools.

This had a very small but very vocal professional backing. I guess Killingsworth of Michigan State was the chief and most ardent exponent of structural unemployment and gave it its academic respectability. But there were a lot of people in Washington who believed or were predisposed to believe that this was the case, including even people in the Labor department who saw this as a grand argument for moving more rapidly on the manpower front, and less emphasis on overall fiscal techniques of dealing with the employment problem.

It created some very strange bedfellows--extreme, if you will, humanistic liberals who saw things as a particular structural--this is a general problem economists have of getting people to see the aggregates. You know, everybody who looks at an unemployment problem sees particular people who are unemployed, and there are always special reasons why they're unemployed. Everybody who looks at prices in an inflationary period can find specific reasons why each and every price that's going up is going up; and yet there's something about the environment that makes a difference on why you have a 7 percent unemployment at one point and 3 1/2 at another, and something about the environment that explains why consumer price index rises at 1 percent one year and 4 percent in another. It's not the special circumstances. Those are always there. It's the overall condition of the economy.

Let me mention another way in which the tradeoff or Phillips curve problem was faced. The Council did want to set an unemployment target, and it did advance 4 percent early in the game as an interim target for unemployment. That was too low for the conservatives and too high for the liberals. We were getting pressures on both sides and excoriated by Leon Keyserling and the labor movement and so forth for having such an unambitious goal.

M: What was your basis for choosing 4 percent?

O: It was a very subjective kind of judgment about where we'd be likely to run into unemployment--the problem of inflation in a serious way. As a matter of fact, I saw Jim Tobin last week. We were trying to recollect one experience. There was a consultants' meeting Walter had in which Paul Samuelson, Joe Pechman, one or two others who were present, and everybody drew his own Phillips curve.

M: You were there, too?

O: Yes--and several of the staff people. This must have been September of '61--or thereabouts--in a world with 6 1/2 percent unemployment and trying to guess where and whether the Phillips curve bent. I remember at the time Jim Tobin said, I think, "Dammit, we ought to keep these things on file and look back on them some day." I doubt that they were ever put in a file. We were both trying to remember who drew the Phillips curve how. I think the general feeling was we would have to make some compromise from the complete stability on wholesale prices and the 1 percent trend on consumer prices that we were getting at the time in order to get the 4 percent unemployment. But you could probably do that with a 2 percent rate of price increase, and we thought that probably would be tolerable. I remember the general judgment that that's about where the public's tolerance of inflation would give out. Nobody at that time would have thought that 3 or 4 percent inflation would be an acceptable situation in the American economy. That's really a judgment about what kind of public reaction you get to the tradeoff between consumer prices and unemployment rather than the question of what the real terms are on which the tradeoff operates.

M: That of course would be very difficult to judge, what the public reaction would be.

O: Yes. You're setting an unemployment target, and you have to ask yourself, "Okay, what kind of price behavior would be likely to accompany that, and will that be an acceptable one."

M: Has this question of unemployment and inflation, the whole concept of the Phillips curve--has this been a central question for economists in the decade of the '60's? Has it been something that the Council has discussed and talked about more or less continually?

O: Well, certainly more from '64 to '68 and '69 than in the early '60's. There's no doubt in anyone's mind that we were pretty far from the ideal tradeoff, compromise point, in the early '60's. I think there is this real distinction between perhaps the '61-'64 period and that since then.

In the first period I think it was really quite easy to diagnose what the economy needed. Our convictions were very strong that what was wrong primarily with the American economy was the lack of vigor of aggregate demand, and the measures to invigorate aggregate demand were the basic answer to the overall problem of prosperity. That's what we were really focusing on, not structural distribution or other problems. But this was the first item on the priority list that the doctor could order for a patient. The problem was that of getting the patient to take the medicine rather than knowing what to prescribe. It was that that put all the emphasis on educating the President, the Congress, the public, making the case publicly--you know, really improving the packaging, the labeling, the palatability of the medicine rather than improving the prescription at that time. Obviously, we did a lot of economic analysis on how big a tax cut we'd like ideally, what the appropriate unemployment target might be, what could be done to supplement general fiscal policy through manpower programs, how well guideposts could help to fend off the evil day that inflation reared its ugly head, and all that. But I think still you'd find that the largest emphasis of the Council's activity was on the salesmanship of a product rather than on the development of a superior product, because that was what the real need was.

And I think it's fortunate historically that Walter's personality and talents fitted in immensely well for that. He's a great publicist; he's a great salesman. No one can put across ideas in more simple and lucid form than he can. He's a guy who loved the limelight and enjoyed the opportunity to really drive this home publicly. I do think the hard economic problems came up when the patient was willing to take our medicine, and we got closer to a point where you had to make some tough judgments on how much stimulus did you want, and what could you do about the tradeoff.

M: This was the problem essentially of the latter '60's, '64 to, say, the present.

O: Yes. It came really late in '65; it really became critical and acute.

M: Does that tax cut in '64 that finally came through under President Johnson represent a milestone then for these new concepts for the New Economics? Is this in a sense a triumph of the ideas?

O: Yes, this was certainly the big breakthrough of unprecedented fiscal action. No one had ever before enlarged the deficit by cutting taxes deliberately at a time when the economy wasn't in recession, wasn't threatened by recession, when federal expenditures were going up. It broke every rule in the book in terms of orthodox fiscal policy. It was an investment in bringing the economy up to full employment. It worked. And within some period of time it was clear that it was working.

M: I would assume that Walter Heller also had to educate Lyndon Johnson when Johnson became President, and that Heller had to, in effect, go through this again with him.

O: Yes, although I don't think he had as much trouble breaking down the balanced budget myth all over again. I think that notion of fiscal orthodoxy had been pretty well dispelled. I'm not sure it ever played as much of a part in President Johnson's ideology as it perhaps had in President Kennedy's. I remember right after President Johnson became President, Walter's having to try to explain the logic of the tax cut, why it was so important, why it deserved top priority on his legislative agenda, and I gather that President Johnson was a very willing student. He accepted the diagnosis. He did push it hard. He got it through. His record kind of amazed everyone.

M: In retrospect, did that 1964 tax reform perform as you predicted? Did it perform adequately?

O: Yes. Great success. I wrote it up in September '65, trying to make some post-mortem estimates, and it all came out looking very healthy. But basically what I'm saying is it wasn't all that hard. There was a lot of room for error in there, and it wasn't the kind of task in terms of taxing one's professional talents and ability that suddenly the later episodes evolved, because it was pretty easy to say, "This patient needs a lot of vitamins and it isn't terribly important whether you administer a couple of teaspoons or a tablespoon-and-a-half." I think the economy could have gone up a little faster in '64 without triggering off inflationary pressures. You did have this elbow room and what came from the fact that we were so far from a desirable point that it was easy to know what direction we ought to be headed in.

M: Let me go back to your interagency relationships in your work. You must have also worked some with the Quadriad. And apparently, from the information I gather, the major--if it can be called that--the main confrontation between the Council and the Federal Reserve System came in late '65.

O: That's right.

M: And for the most part the rest of the time the relationship was rather harmonious, is that correct?

O: That's correct. There was much less relationship with the Federal Reserve prior to that event that there was after that event or than there was with other agencies. The quadriad was organized very differently from the Troika. With one exception I'll go into in a minute, there wasn't an attempt to develop a coordinated position or staff effort that flowed up the line. There were meetings- there were efforts for consultation and so forth, involving Bill Martin, and almost invariably in the early years, as I understand it, involving Bill Martin alone. I don't think the Council ever met as a group with the Federal Reserve Board as a group during that early period. There was a fair amount of contact with people on the staff of the Federal Reserve, although even that wasn't a tremendous effort. It was sort of with individuals as individual economists and not in any coordinated way.

Now in '65 Dan Brill got promoted at the Federal Reserve Board to a more senior staff position. I don't think it was quite the position he has today, but that was an important development in coordination. He worked very closely and was very friendly with members of the Council, and I think that improved the coordination.

During the summer of 1965 Martin was getting concerned about excessive monetary ease, really, I think more in terms of financial market conditions than some threats of unsound financial structures in the financial institutions--too much borrowing by consumers and so forth, rather than in terms of an overall judgment that the economy was going too fast at the time. Very few people were predicting boom in the economy in the summer of '65, even after the initial Viet Nam appropriation went up. There were many more people concerned about this overaged expansion dying out than about a takeoff into a boom. And the famous Martin speech of June '65 was focused largely on the stretched-out financial system and speculation and the like rather than on a general overheating of the economy. But nevertheless I think this did pose an issue. Martin talked about tightening.

And there was an agreement in September '65, as I recall, to start some coordinated staff work. We asked the President to ask a set of questions--I'm not sure to what extent this was suggested to him by someone else--"what are the experts' views on where the economy is going; and what's the threat of inflation; would tighter money help on the regulatory supervisory front; or should we be doing things there? If our effort is really to tighten up on abuses of credit markets, do you want to just cut the total flow, or do you want to pinpoint the abuses?" I think that was a very key question of strategy, and if you do it by regulating the overall flow of moderating it, you impose more restraint on overall economic activity than you want.

In light of these questions, Martin agreed to have some kind of a joint staff effort. It was the only time that one was launched. There was a special quadriad group that was formed to supervise this research--Paul Volcker of Treasury; Charlie Zwick, who was then Assistant Director of the Budget; Dan Brill; and myself. As our work went on, it became increasingly clear that the economy was speeding up and that some of these problems were getting to be more general economic problems. But we still doubted strongly on the basis of what we knew and thought we knew and believed about federal spending and the like, that it was a real threat.

We did basically write a memo which we completed about the 1st of November in '65, which went somewhat beyond our mandate. I thought Brill was living dangerously in taking the position he did. It really was a policy recommendation saying we ought to keep monetary policy about where it was, should not tighten for the remainder of the year, consider in light of the budget where we would be for 1966; and if GNP outlook exceeded seven hundred and twenty billion or so, that would be a signal for a tightening-up policy which might call for higher taxes or for a tightening of the monetary policy. Basically the judgment would have to be made at that time of the degree and the choice of instruments used for restraint.

Basically our judgment at the time was the 720 GNP for 1966 looked 'way out of the question. The typical standard business forecast was running around--I remember one of the business economists labeled it the "Jet Model forecast."--everybody who had a 707-billion GNP for 1966. But we weren't putting ourselves in the position then of committing ourselves to a particular forecast.

I remember when we signed the document, Brill said, "I'll bet we've made monetary policy for the rest of this year." He said, "Well, Martin's going to feel obliged to distribute this, and it's a pretty reasonable position for arguing against taking action now. A lot of guys on the Board are predisposed not to take action anyway; it gives them a good consensus excuse for doing this."

Well, it turned out that the Fed did move the next month, and that memo was never distributed to the other members of the Federal Reserve Board. In fact, Sherm Maisel testified in pain some months later that he'd just found out about its existence, and he had never seen it. Bill chose to sit on it. His own argument was that financial markets just wouldn't wait, and that there was a sufficient danger of a real mess that required the Fed to act at that time rather than waiting to make a coordinated budget decision.

We'll never know, but I still feel that there's some chance that if monetary policy had not committed itself to restraint, that you could have made a better argument for going up with a tax increase in the January '66 budget, which would have been highly desirable. It would have been possible at that time to say, "Look, we're threatened with inflation. Something is going to have to be done on the restraint side. We don't want tight money."

Well, once the Fed moved, they seemed to be committed to tight money anyway, and any tax proposal could no longer rest heavily on that kind of a sharply defined choice between this or tight money. You could still have maybe argument that money would have to get a lot tighter, but it didn't pose the thing in a saleable way.

After that, the sense of failure of communication and of some personal unpleasantness on both sides from this split on policy led to a very determined and much more formalized effort at coordination. We had lunch at the Federal Reserve starting February 1966 every two weeks on Thursday--

M: Was this the entire Council?

O: Yes. The three of us and almost seven members of the Board always invited--had good, although not perfect, attendance; Martin typically there. And as a result of this, there was a much more--there was informal things that flowed out of this. You'd get into a luncheon conversation; somebody would follow it up; and there'd be phone calls and such.

M: This was prompted on both sides then?

O: Yes.

M: Both the Council and the FRS saw some lessons then--

O: Yes. I think the actual invitation came from Bill Martin.

M: And since that time the coordination has been better.

O: Much better. I developed rather good personal relations with Martin, and came to respect--although I'm not sure I understand the guy a great deal--and I think really to sense what an honest and conscientious broader guy he is than his public image.

M: It's 4 o'clock and you have work to do. I think this would be a good time to break, and we can take up with this the next time.

O: Sure.