ECONOMIC THEORY IN TRANSITION:

ECONOMIC POLICY CONFUSION IN THE UNITED STATES DURING STAGFLATION AND ITS IMPLICATIONS TO KEYNESIAN ECONOMICS

Olli Huhtamäki

University of Helsinki

Faculty of Social Sciences

Political History

Master’s thesis

January 2013
The thesis studies the economic policy of the United States from the first oil crisis of October 1973 to the 1980 elections via the perspective of Keynesian economic theorem. The main objective of the thesis is to analyze the perceived failure of Keynesianism during stagflation through practical policy and evaluate the policy connection to the economic theory paradigm shift that occurred in the late 1970s and early 1980s. This is done by reviewing primarily the fiscal policies of the Ford and Carter administrations coupled with an analysis of the policy recommendations made by the contemporary congressional Joint Economic Committees. The thesis aims to add a historically minded policy analysis into the mix when explaining the fall of Keynesianism and see how well it elucidates this on its own.

In primary material the thesis relies on various documents produced by the Councils of Economic Advisors and Joint Economic Committees during the previously mentioned time period. In particular the annually or biannually formed economic policy publications and statements related to them are under scrutiny since by revealing the policy directions and proposals one can examine the wider economic theory context at play. In addition the primary material is complemented by using a wide-range of previous literature and contemporary newspaper articles.

Methodologically the study employs directed qualitative content analysis as a research method which carefully takes into consideration the chosen contextual theory – Keynesianism – when analyzing the material. Furthermore, an adaption of Douglass C. North’s theory on economic change is applied to the subject in order to create a more comprehendible framework to examine the change in economic thinking taking place.

The analysis of U.S. economic policy through the theoretical lenses of Keynes finds that the theory was badly miscomprehended and practiced already in the late 1960s which continued for the entire 1970s causing increasingly significant reputational damage to it. The study concludes that a lack of belief among the Ford and Carter administrations towards Keynesianism and the difficult politico-economic circumstances lead to economic policies that cannot be classified as Keynesian. Thus the results stand in opposition to the notion that the theory failed through trial and error during stagflation and indicate that intellectual preference towards neoclassical economics began to impact policy increasingly since the Ford administration. The study recommends that future research focuses more on linking economic policies and theories to their historical and political context. A further recommendation is made to increase the study of empirical policy analysis when explaining the fall of Keynesianism.

Avainsanat – Nyckelord – Keywords
Keynesianism, Economic history, Stagflation, United States
# Table of Contents

Timeline ......................................................................................................................... 1

I: Introduction ................................................................................................................. 2
  1.1. Research Questions ............................................................................................. 4
  1.2. Previous Research ............................................................................................... 6
  1.3. Methodology ........................................................................................................ 10
  1.4. Material ................................................................................................................ 12

II: A Prologue to the Interpretation of Keynesian Economics in the United States Prior to the 1970s .................................................................................................................. 16
  2.1. Theory .................................................................................................................. 16
  2.2. The Political History of the Theory .................................................................... 19
      2.2.1 From Heresy to Policy .................................................................................. 19
      2.2.2. After the Employment Act ........................................................................ 22

III: “Public Enemy Number One” – or not? ................................................................ 27
  3.1. Economic Legacy Inherited by Ford ................................................................... 27
  3.2. Whip Inflation Now ............................................................................................ 30
  3.3. Choosing Between Austerity and Tax Cuts ......................................................... 34
  3.4. Fiscal Policy Preceding the 1976 Elections ......................................................... 40

IV: Carter Administration’s Economic Policy Alignments ......................................... 45
  4.1. Campaign Pledges, Initial Programs and Changing Course .......................... 45
  4.2. The Humphrey-Hawkins Act ......................................................................... 50
  4.3. Embracing Austerity ......................................................................................... 54
  4.4. Joint Economic Committee Finds Unanimity in Supply-Side Policies .......... 59
  4.5. The Role of Economics in the 1980 elections .................................................. 65

Conclusions .................................................................................................................... 70

Bibliography .................................................................................................................. 76

Appendix 1. Composition of Joint Economic Committee’s, 93rd – 96th Congress .......... 86
Appendix 2. Excerpt from Joint Economic Committee Hearing October 28th 1975 ....... 89
Appendix 3. Additional Figures and Statistical Tables .................................................. 91
**Timeline**

**October 17th 1973.** Oil ministers of OPEC member countries agree to an oil embargo. The first oil crisis follows.

**August 9th 1974.** Richard Nixon resigns.

**October 8th 1974.** Gerald Ford holds “Whip Inflation Now”-speech before Congress.


**November 2nd 1976.** Incumbent Gerald Ford loses presidential elections to Jimmy Carter.

**May 13th 1977.** Carter signs economic stimulus Act allocating $7.9 billion to public service jobs.

**January 19th 1978.** Jimmy Carter declares that government is unable to manage the economy in his State of the Union Address delivered before Congress.


**November 4th 1979.** Islamist students and militants take over the American Embassy in Tehran. As a result Carter bans oil imports from Iran aggravating the second oil crisis.

I: Introduction

“"It will not be easy for future historians to account for the fact that, for a generation after the untimely death of Keynes, opinion was so completely under the sway of what was regarded as Keynesianism, in a way that no single man had ever before dominated economic policy and development. Nor will it be easy to explain why these ideas rather suddenly went out of fashion..."” – Friedrich von Hayek

In the midsummer of 2011 the American political image was badly tainted by the bitter partisan quarrel over the federal debt-ceiling. Democrats and Republicans alike knew that the ceiling had to be increased or the federal government could not maintain its operations, yet an issue that was supposed to be merely technical, developed into a principled debate about the federal budget deficit and debt. This clearly illustrates how an instable economic situation aggravates sovereign budget negotiations. Part of the reason why this happens is because the federal budget has a connection to debates regarding economic theory. In troubled economic times especially, fiscal policy gains in importance, since a prominent economist once offered expanding it as a solution out of recessions, while others see it always as a tool that causes nothing but unavailing government growth. As the debt-ceiling crisis demonstrates, this topic is still highly debatable and politically volatile. Moreover, it is an issue that has bisected the thinking of the modern political economy for several decades, if not centuries, and where reaching a consensus seems to be momentary and especially difficult during a recessionary period. At the moment governments prefer cutting their expenses during economic recessions, clearly evident in the currently dominant economic policy ideas in the European Union and, to a lesser extent, the United States; deficit-reduction, as opposed to battling unemployment, has become the main priority during downturns. This, however, was not always the state of affairs.

After the Second World War political thought – in capitalist societies – was largely supportive of Keynesianism even though it encountered some criticism. Nevertheless, the dominance of Keynesianism in government and academia faded in the 1970s and

---

1 Hayek, Friedrich: Contra Keynes and Cambridge. In the book Caldwell, Bruce (edit.): Contra Keynes
early 1980s. In the aftermath Keynesian macroeconomic theory was ridiculed for not providing a valid microeconomic theory and basing its models on naïve, outdated assumptions that did not emphasize adequately the supply-side of the economy and neglected the understanding of human incentives. Eric Hobsbawm writes of the shift in economic thought in his classic 20th century historical work *The Age of Extremes* by emphasizing the importance of a large, drawn-out practical failure of the Keynesian school in the late 1970s. There were various anti-Keynesian economists in the western world during the post-war decades, but they gained little notice in functional economic policy, since the Keynesian school had been so wildly successful in delivering prosperity and economic stability to western societies. However, in stagflation anti-Keynesian economists, such as Milton Friedman and Friedrich von Hayek among others, finally received the long-awaited functional failure substantiating their theories and giving them credence during the apparent ineffective state intervention to this crisis. This credibility was reflected in the academic circles – Hayek and Friedman won the Nobel prizes in economics in 1974 and 1976, respectively – as the so called Philips curve depicting the inverse relationship between unemployment and inflation fell through.

In time, the perspective promoted by monetarist and neoclassical economic thinkers gained a wide constituency in politics and they received influential government positions usually on the coattails of more or less conservative politicians. Economist Nicolas Spulber argues that in the United States skepticism regarding the capability of the federal government to manage the economy started to increase significantly in the mid-1970s as stagflation (an economic condition combining concurrent inflation and unemployment along with low productivity growth) appeared and climaxed in the very beginning of the 1980s. This is well exemplified in American political history with Ronald Reagan’s – emphasizing this skepticism with continuous assaults on the inaptitude and inefficiency of the government – landslide electoral victory over the

---


incumbent Jimmy Carter. What is noteworthy is that Carter got elected by using the opposite economic rhetoric in 1976 – that is state intervention in the form of expanding the economy. Examining the economic policies of the Ford and Carter administrations is therefore essential in assessing this phenomenon, since between the first oil crisis of 1973 and the presidential election of 1980 there should be clear signals of failure within the theory and affirmative government itself that justify the ascension of Ronald Reagan’s negative government. At least if the downfall of Keynesianism follows the argument of science historian Thomas Kuhn, who states that dominant scientific theories of the day are subdued by the accumulation of unpredicted events, anomalies, which are given ultimately incorrect ad hoc explanations.\(^5\)

1.1. Research Questions

However, in the historical notion of failure during stagflation lies not only the technical invalidity of the Philips curve, but more importantly, an implicit assumption that counter-cyclical Keynesianism had been proven false through trial and error in government policies.\(^6\) Whether or not this assumption holds true is put to the test in this thesis by reflecting the foregoing notion against the practical fiscal and to a much lesser extent monetary policy of the United States and how well it actually portrays the thinking of John M. Keynes and his most prominent followers. Other economic policy aspects, such as exchange rate- and income policies, are excluded from the study not only for outlining purposes but also because the central focus of Keynesian theory is in this thesis seen as revolving mainly around fiscal and monetary policy.

Admittedly the U.S. has never been the strongest advocate of Keynesian policymaking compared to, for example the Nordic countries, but during the postwar decades it represented (at least in the Western World) the main economic power, whose decision-making in this field of interest did not only have an immediate impact on the world economy, but also an indirect influence to the formulation of economic policies within


\(^6\) For instance, in 1996 Paul A. Samuelsson noted in an interview that “the failure to solve the ongoing problem of stagflation was the most important nail in the coffin of Keynesianism.” Cassidy, John: Postscript: Paul Samuelsson. The New Yorker December 14\(^{th}\) 2009. (http://www.newyorker.com/online/blogs/johncassidy/2009/12/postscript-paul-samuelson.html).
its allies. On the other hand, the author is fully aware that the analysis of one country’s economic policy from a rather narrow perspective does not represent the whole picture of what happened to Keynesianism but can at most give thrusts to the right direction. Nonetheless, the paradigm shift from Keynesianism to neoclassical economic policy and the widespread popularity and discursive hegemony gained by the latter is so aggressive in the case of the United States that it offers a fascinating background for a study related to this issue.

In short, this dissertation focuses on whether the macroeconomic theory of Keynes was followed in practice by examining the economic policy of U.S. administrations beginning from the oil crisis of 1973. The aim of this study is to provide an additional viewpoint in analyzing the popular conception – that Keynesianism in general experienced a so-called death in the 1970s – by studying the economic policy of the United States during the era of stagflation. Moreover, by detailing the fiscal policy of the Ford and Carter administrations and how they represented the typical mixed economy response towards recession may provide further ground and insights in assessing whether or not the perceived failure of Keynesian macroeconomic theory in the era of stagflation is justified.

Did the Ford and Carter administrations respond to stagflation with the typical macroeconomic methods and, subsequently, do they reflect the elements ordinarily associated with the failure of Keynesian economics? Furthermore how was the theory interpreted in the political context of the United States and what influence did it have on the general success of Keynesianism, especially during stagflation? This threefold approach and the ultimate research goal to which they aim to assist are illustrated in figure 1.
1.2. Previous Research

The general topic introduced here is by no means unexplored and requires therefore a profound analysis of the prior studies conducted in order to present the novelty factor of this particular thesis.

Ordinarily the general downfall of Keynesian economics in the 1970s can be attributed to three mutually reinforcing causes:

1) The oil crisis of 1973, that quadrupled the price of oil in a matter of months, caused a massive supply-side shock that reflationary demand-management policies tried unsuccessfully to curtail. The slow recovery was tempered by increasing inflation, which was further aggravated by the second oil crisis in 1979.\(^7\)

2) Nixon’s decision to close the gold window in August 1971 made the dollar inconvertible to gold directly and ultimately led to the end of the Bretton Woods system in 1973. The crumbling of this system, that Keynes had himself helped to create in 1944, resulted in a fundamental instability in the world economy making national economies extremely prone to volatile shifts in the business

cycle. In particular interest rates became more dependent of global financial markets than national monetary policy.\(^8\)

3) In a world of increasing globalization Keynesian demand-management did not have the same national impact that it used to have and became futile.\(^9\) The essential supposition being that in an open economy reflationary measures would, by boosting consumer demand, also increase imports and lead to a current account deficit.

These are all major structural causes that aim to explain the fall of Keynesianism in a broad manner. They do not, however, offer any explanations into the particular national policies that led to the theory’s descent.

Prior studies related to U.S. economic policy during the Great Stagflation (as Spulber labels it) have centered on the momentous change of macroeconomic theorem and its consequential implications for the economy in general but tend to overlook the policy-specific causative reasons. For instance, economic historian Samuel Rosenberg – despite providing various insights about the mistakes in economic policy – mainly explains the cause of stagflation in the United States by referring to a fundamental problem triggered by the increasing competition in world markets and changing attitudes in the domestic business environment; thereby relying on the second broad causative reason described above.\(^10\) Influential economist Martin Feldstein, who served as Reagan’s chief economic adviser, lays the fault on the economists of the 1970s who in his view badly underestimated the consequences of inflation, but refrains from blaming past U.S. administrations from particular economic policy reactions that aggravated stagflation.\(^11\) Feldstein’s case against the inefficiency of Keynesianism rests more on the primary conditions it entailed, such as unemployment insurance, welfare restrictions and minimum wage rather than detailing its specific policy blunders. It is

---


debatable whether these conditions in themselves can be viewed as Keynesian, as Feldstein implies, since they can either be seen as built-in automatic stabilizers for the economy (i.e. they automatically increase demand in a downturn in which case they could be considered Keynesian) or alternatively as legal frameworks that do not de facto compensate for economic resuscitation as such.

Historian Arthur M. Schlesinger resigns himself to the notion that the administrations of the 1960s and 1970s made costly policy mistakes that conveyed the American voters to forget about the legitimacy of government intervention and opened the Pandora’s box of federal authority mistrust – always in the undercurrent of American politics – and led to the demise of Keynesianism. Yet Schlesinger’s all-encompassing power corruption theory, which sets the blame partly on historical cycles, is rather vague and lacks analysis of the specific programs and mistakes that form the basis of the author’s conclusions. Furthermore, because Schlesinger primarily credits the fall to policy blunders of the late 1960s the scrutiny of the sequential decade is left somewhat tangential. Most importantly, it does not differentiate between government economic interventions and Keynesianism but sees them largely as synonymous; a conceptual blurring that will be dealt more specifically in chapter II.

On the other hand, there are qualified studies that separately analyze the economic policies of the Ford and Carter administrations. Notably the works of Yanek Mieckzkowski when it comes to the former and Anthony S. Campagna with respect to the latter. Mieckzkowski covers the political history of the Ford administration carefully and introduces various turning points that had a significant impact on the economic policy initiatives of the administration. Then again Mieckzkowski emphasizes the surrounding economic and political context to a degree that leaves Ford himself without any powerful influence when it comes to policy decisions. This notion to a large extent makes the analysis deterministic in nature and leaves out the novelty value of the Ford administration’s economic policies when compared to its previous post-World War II counterparts. Campagna has narrated the economic policies of the United States from the First World War to the mid-1980s with laudable fidelity and in another work

---

focuses specifically on the Carter administration\textsuperscript{15}, but lacks in describing the political aspects involved and the historiographical viewpoint of how it affected macroeconomic theorems in the larger perspective. It is noteworthy that while both of these scholars apply themselves to a meticulous study of the administrations’ economic policies in question (and in the case of Mieckzkowski to various other issues as well) they do not, at least explicitly, focus on the analysis of primary material. More importantly they do not offer any clear insight if the administrations significantly influenced the outcome of the wider context at play. That is to say, what was their possible impact to the subsequent shift in dominant economic theorem?

In other words, all of these studies neglect the unique relationship between Keynesian economics, the United States and the specific economic policy programs that took place within the 1970s. Furthermore it is worth noting that the previous research presented here offers various answers to the demise of Keynesianism in the United States that are to some extent even contradictory e.g. Schlesinger’s and Rosenberg’s arguments. This not only highlights the scholarly difficulty when assessing politico-economic affairs, but also reveals that a unanimous answer has yet to reveal itself.

In the book \textit{The Political Power of Economic Ideas: Keynesianism across Nations} Walter S. Salant describes how the Keynesian revolution took place in the United States. Salant focuses on the ideas of Keynes and how they affected the policymaking in the White House and Congress during the Great Depression and post-World War II decades, but repeatedly bypasses the analysis with respect to the 1970s.\textsuperscript{16} To be fair, this is not specifically under scrutiny in the article, but the book itself is a manifest to how particular political circumstances and actors played a remarkable role in the fact that Keynesianism gained such a prominent place in the Western World. Consequently the argument leaves open the possibility that this thesis aims to explore: the specific political circumstances that surrounded Keynesianism in the United States during stagflation. It is the view of the author that prior studies regarding the topic have not

\begin{itemize}
\end{itemize}
sufficiently combined the theoretical with the empirical and political sides of the story. Hence this thesis aims, not to overturn the structural reasons presented earlier, but to complement them with the detailed empirical study of one country, its economic policy, and the political framework surrounding it.

1.3. Methodology

This thesis aspires to combine various research methods and theories together in order to make an analysis as comprehensive as possible. In this case the goal is to utilize multiple theoretical insights in addition to the designated scientific method with the intention to validate the data through cross verification. This so-called theory-triangulation helps in preventing conflicting deductions and providing the study with scientifically more reliable results.\(^{17}\)

It is of paramount importance to note that, for the sake of credibility, Keynesian theory plays a dual role in the study: it is not only the subject of the research at hand but also forms the theoretical framework surrounding it. The theory itself is carefully clarified and interpreted in chapter II. First, however, the selected research method coupled with the ancillary theory that this thesis capitalizes on need to be presented.

The premise of this dissertation is that economic policy is never done in a political vacuum. That is to say when economic theory makes the transition to economic policy it is often modified or to some extent even distorted to serve specific political goals. Thus an analysis of the political context in which economic policy is done is equally important than scrutinizing the original theory itself, especially when we take into consideration the fact that the success of a macroeconomic theory is, in general, assessed by its outcome in reality i.e. economic history. In other words economic theory interacts with policy debates and government economic management – which, due to its nature, is particularly accurate in the case of Keynesian economics. The role of political interpretation regarding economic theories and their consequences is therefore the main theoretical outline of this study.

In this study the aforementioned framework and material will be researched by the means of a *directed qualitative content analysis*. This means that the subject material will be approached through a contextual theory – in this case primarily Keynesianism – and analyzed according to the general principles of content analysis. Fitting the material into the historical framework and analyzing it with this technique will leave room for interpretation, as always in social sciences, but will still to some extent try to preserve the advantage of quantitative analysis which allows the content to be categorized with respect to the research questions involved. In short the main idea of qualitative content analysis is “to formulate a criterion of definition, derived from theoretical background and research question, which determines the aspects of the textual material taken into account. Following this criterion the material is worked through and categories are tentative and step by step deduced.”

In this thesis directed qualitative content analysis thus means that the phenomenon and chosen material is analyzed through an interpretation of the economic theory of Keynes.

The foregoing research method if applied only by itself would, however, make this thesis a matter of purely empirical evidence, in which Keynesianism would be coupled with historical facts regarding the economic policy of the scrutinized administrations. Considering the fact that the same historical evidence can be interpreted in a number ways by different historians, there remains space for an additional methodological theory that would help in comprehending the issue involved. In this connection the thesis utilizes a theory regarding economic change developed by economist and economic historian Douglass C. North.

In *Understanding the Process of Economic Change* the Nobel laureate displays a continuum between different components that ultimately impact the way the economy at large mutates. The pattern of economic change is as follows: perceived reality→beliefs→institutions→policy→altered perception of reality. North uses the rise and fall of the Soviet Union as an example to provide content to this description and incorporates a number of insights about the functioning of institutions, structure, individuals and their interplay. According to North all organized activity by humans

---


entails a structure to comprehend the way the economy works, but this structure is a human made creation whose habits are not automatic or “natural”. In other words North emphasizes the underlying human control and irrationality in economic activity when uncertainty rears its head.

This thesis sees that North’s theory – even though it mainly emphasizes the substantial role of institutions and refers to economic change in a more ubiquitous way – is applicable to the research questions at hand since it provides a loose framework that can be transformed into the analysis of Keynesianism’s fate in the United States. The thesis aims to cover the way in which the theory was originally incorporated into American politics (perceived reality and belief) and then sharpen focus into specifically the policy component in North’s equation. That is to say, how various policies reflected the underlying beliefs and ultimately in conjunction affected the altered perception of reality – in this case the notion that Keynesianism had failed through trial and error.

North himself ascribes importance to this kind of economic history evaluation by asking a leading question: “if we are continually creating a new and novel world, how good is the theory we have developed from past experience to deal with this novel world?”

While a modification of North’s theory significantly helps in grasping various questions linked to the change of Keynesianism in the United States (how did the beliefs get formed? How did they change? Whose beliefs mattered?), this thesis realizes that the full use of it remains beyond the scope of this study and its research questions, especially in regard to institutions. Therefore this dissertation does not acclaim to present the entire process comprehensively but instead tries to provide elements of its fundamental nature through the policy variable. It is worth stressing that the function of North’s theory is mainly to assist in comprehending the findings of the research and that a loose theory such as this one cannot provide unanimous answers.

1.4. Material

The dissertation attempts to answer its research questions by delving into a number of primary document material related to the economic policy of the United States during

---

the Ford and Carter administrations – and to a lesser extent their predecessors. This thesis relies most importantly on the annual *Economic Report of the President* document (from now on the abbreviation ERP is also used) produced by the President and his Council of Economic Advisers (from now on CEA) since it is published in conjunction with the *Annual Report of the Council of Economic Advisers*. These statements together give a clear perception about the economic objectives and means of the contemporary executive branch. Furthermore the annually formed *Budget of the United States* document with its *Budget Message of the President* emphasizes the particular budgetary issues involved when making fiscal policy in particular and provides valuable insights into the minds of any administration’s economic viewpoint. It is, in fact, a collection of documents and supporting data which includes information about the President’s budgetary proposals for a given fiscal year but also analyzes it (although in a more or less partisan sense). This document is the president’s recommendation to Congress for what the budget should be for the next fiscal year. Prior to 1971, the report was organized by the Bureau of the Budget. From 1972 it has been prepared by the Office of Management and Budget in conjunction with the Executive Office of the President. Additionally, other economy-related documents e.g. special reports prepared by the CEA, the Presidents’ speeches, other announcements and legislative initiatives will be taken into account when forming an analysis of the administrations’ economic policy, even though they are not at the center stage of the study’s primary material. The official reports produced by the CEA and the Office of Management and Budget are highly economics-centered which adds a level of technical difficulty into the research yet due to their essential significance they cannot be bypassed when studying U.S. economic policy – specifically fiscal policy.

Nonetheless, the executive branch cannot be the sole source of examination if a better understanding of the theoretical and political surroundings of economic policy is to be achieved. Therefore the thesis also makes good use of documents produced by the Joint Economic Committee during the aforementioned time period since this particular joint committee, comprised of altogether 20 Senators and House representatives, offers valuable – albeit limited – information about the Congressional perspective to economic policy. Despite the lack of legislative authority the Joint Economic Committee (from now on the JEC) can be considered as the main economic forum in Congress and thus it is obviously important if one wants to grasp the general economic policy sentiment.
among U.S. policymakers. Furthermore the advisory role of the organ can be largely seen as positive matter for answering the research questions posed in this thesis since the JEC, due to its consultative role, views economic policy from a more philosophical perspective than other Congressional Committees\textsuperscript{21}, such as the Senate and House Committee’s on the Budget, which have to focus more on the legislative and practical consequences of their policy making. The studied documents include various selected reports and hearings of the committee, but concentrate predominantly on the annual \textit{Joint Economic Reports} which correspond and analyze specifically the previously cited \textit{Economic Reports of the President}. Pursuant to the requirements of the Employment Act of 1946 the report, with its analyses, commentary and conclusions, aims to assist numerous Committees of Congress and its members in general as they contemplate economic issues. Most importantly when Capitol Hill is controlled by a different party than the White House, this report offers crucially comprehensive, but yet condensed information revealing the struggle and counter-arguments involved at the contemporary political discussion about economic policy. Even if Congress is in step with the President’s economic policy, the document includes a minority view. Appendix I shows the compositions of the JEC during the studied period and may be helpful in comprehending the motives behind the committee’s economic policy suggestions.

Furthermore, the JEC holds hearings and publishes studies that attempt to comprehend the economic policy of the current administration and suggest ways in which it could more effectively practice economic policy and also debates various other economic issues. These hearing often include the opinion of prestigious members of the national academic community. Hence analyzing the material produced by the JEC does not only offer an accessible view of the political context involved, but also conveys the logic of noted economists and researchers, which makes it an extremely comprehensive vantage point for evaluating the questions that this thesis aims to explore. Additionally, from a research perspective the material produced by the JEC has rarely been taken into account when studying U.S. economic policy which helps in giving the research a more original angle.

\textsuperscript{21} Ralph K. Huitt, former professor of political science at the University of Wisconsin, once called it a political anomaly: “A planning and theory group in a culture fiercely devoted to the short-run and practical.”
As mentioned earlier, the topic contains a wide-range of eligible secondary literature which is also taken into account and made good use of in order to achieve conclusions that make as much justice as possible to the historical period and perspective investigated. Additionally, the dissertation employs various contemporary newspapers articles and editorials that provide further food for thought by frequently revealing explicitly stated notions related to the economy that could not be found in the primary material. For instance, the economic remarks made by nominees, incumbents and their respective personnel during Presidential election races are crucially important, since they emphasize differences between candidates with regard to economic policy issues and often cut through the economic jargon and ambiguity entailed in certified documents. These secondary sources are juxtaposed with the primary material – the official Government JEC documents – in an attempt to reconstruct the historical conditions surrounding economic policy during the research period and make valid deductions from it.

Before delving further into the details of how Keynesian economics lost its ground in the minds of academia, politicians and people in general, it is necessary to briefly summarize what the theorem stands for and how it has been defined and interpreted. Furthermore, the political history of affirmative government economic policy in the United States is necessary, since without understanding the context and history, developing arguments about economic policy guidelines of the Ford and Carter administrations might lead to anachronistic or off-key conclusions.
II: A Prologue to the Interpretation of Keynesian Economics in the United States Prior to the 1970s

2.1. Theory

The definition of Keynesian economics is one that this thesis aims to justifiably explain in order to make subsequent deductions more understandable. Keynesianism is usually referenced as a macroeconomic theory that gains acceptance during periods of recession. Thus it is only natural to conceive it as an economic theory that is designed for depression-like conditions. Yet as a radical attack against the entire economic orthodoxy – not capitalism itself – of its time it would be erroneous to view it only as a one-dimensional theory that encouraged deficit-spending. Due to the various mistaken definitions of Keynesian theory it is important to illuminate its content despite the historiographical nature of the study.

John Maynard Keynes wrote his masterpiece *The General Theory on Employment, Interest, and Money* in 1936 after being inspired by the Great Depression in the United States, its root causes and possible solutions. Keynes preferred applying economic theory to practical issues and often commented about the economic role of some contemporary state of distress, whether it was the Versailles peace Treaty (*The Economic Consequences of Peace*), the Gold Standard (*The Economic Consequences of Mr. Churchill*) or how to manage disastrous unemployment (*The Means to Prosperity*). Therefore after the book’s publication - in a debate regarding the specific practical details surrounding the theory represented in *The General Theory* - Keynes highlighted this tendency in relation to his ideas by writing:

“If the simple basic ideas can become familiar and acceptable, time and experience and the collaboration of a number of minds will discover the best way of expressing them.”

The question arises; did the men responsible of this task find the best ways of expressing the ideas of Keynes or was he overly optimistic when relying on them?

---

Krugman summarizes the main conclusions of *The General Theory* to four bullet points:

1. Economies suffer from an overall lack of demand
2. The economy’s automatic tendency to correct shortfalls in demand operate slowly and painfully
3. Government policies to increase demand can reduce unemployment quickly
4. Sometimes monetary policy might not be enough and government spending must step into breach

As these bullet points implicate Keynes had in *The General Theory* once again constructed an economic theory towards practical relevance, inasmuch as offering in the form of expansive fiscal policy the solution to inadequate demand – and consequently to the contemporary economic crisis. Furthermore, as the last principle insinuates monetary policy is effective unless the economy is allowed to evolve from a recession to a state of depression when it becomes ineffective (liquidity trap) and aggressive government spending comes into play. It should be taken into account that at the time of writing the *General Theory* interest rates at the United States, for example, were near zero and still could not spur private investment to act, which is why Keynes underplayed the role of monetary policy – steering interest rates – and emphasizes fiscal policy instead. He did not offer a concrete theory that could unambiguously be applied to different economic conditions. His critic of the time, Joseph Schumpeter, said that he offered advice that “…in the garb of general scientific truth, advice which carries meaning only with reference to the practical exigencies of a unique historical situation of a given time and country.”

Thus the creator of the theory was not as dogmatic a thinker as the subsequent feud might suggest. Yet that is closely how a number of critics afterwards have interpreted his theory, especially after the fall of it occurred. Historian John Gordon Steele, for example, describes Keynesian macroeconomic theory as a faulty prescription since Keynes, to Steele’s understanding, observed the economic world from a mathematically

---


constructed point of view and perceived the economy to be a machine that is as predictable as Newton’s clockwork universe.\(^4\) Regardless of the fact that Keynes himself had been quite case-specific in his advices – as Schumpeter’s critique illustrates – and founded his theories upon the notion of uncertainty which, as his biographer Robert Skidelsky states, dominated his economic thinking.\(^5\)

Another common misunderstanding is that Keynesianism opened the doors to unlimited deficit-spending to politicians. This argument was made extremely forcefully by James Buchanan and Richard Wagner in their book *Democracy in the Deficit*, which was published in the spring of 1977 as Jimmy Carter was entering the White House (the consequences of this newly invigorated pledge against active government policy will be dealt with in subsequent chapters). The book incorporates public-choice theory to explain the norms of Keynesian economics and blames it for ruining the “fiscal constitution” of the United States and other countries. In the book Buchanan and Wagner describe *pre*-Keynesian fiscal policy as a responsible policy that “---supported a budget surplus during normal times so as to provide a cushion for more troublesome periods”\(^6\) without realizing that this was exactly what Keynesian macroeconomic theory was principally all about; creating surpluses in good times and relying on deficits when an economic downturn occurred. Keynes preferred government budgets to typically be in surplus.\(^7\) Thus the claim that Keynes with his theory undermined deficits in general is not true. On the other hand the argument that it opened the doors to politicians for continuous deficit-spending is more complex and one that this thesis, with its merging of economic theory and political context, aims to answer.

It may be helpful to distinguish three concurrent revolutions that took place in economic sciences in the first third of the twentieth century in order to understand that Keynes and his theory coincided with other economic insights which despite being credited to the theory have little to do with its main conclusions. Paul A. Samuelsson outlined these three revolutions after 1930 as 1) the Chamberlin-Robinson revolution consisting


\(^7\) Skidelsky, xvi.
mainly of the realization of imperfect competition, 2) the Keynesian revolution and 3) the econometric revolution linking the increased use of mathematics in economic analysis. Thus it is somewhat erroneous to link Keynesianism either as the preacher of state-controlled entities, which is more linked to the first Chamberlin-Robinson revolution and to the enlargement of a modern welfare state as such, or to mathematical prowess which developed on its own and – despite providing more tools to implement Keynesianism – was not an integral part in explaining its basic idea (Keynes himself shun away from overtly mathematical trains of thought). The underlying bogeymen of socialism and doctrinaire à la math linked to Keynes are therefore, more often than not, caricatures of an economic theory that does not exist.

2.2. The Political History of the Theory

“We had somewhat of a struggle, to keep him from drifting into that foolish notion that it was necessary to make large appropriations on public works to give employment to laborers. But the Secretary of Treasury and I united our forces in dissuading him from the scheme, insisting that the true remedy was economy and retrenchment.”—James A. Garfield in a letter to B.A. Hinsdale in 1874.

2.2.1 From Heresy to Policy

As the quotation above exemplifies, the idea of using government programs in times of depression was something that had crossed the minds of politicians before Keynes. More broadly speaking, affirmative government – in the economic sense – was something that had caused friction in the U.S. since its birth. For example, Alexander Hamilton and Thomas Jefferson argued fiercely over the former’s Funding Bill of 1790, which created federal bonds and thus addressed the issue of domestic debt, since Jefferson thought that it exceeded the powers of the national authority. Schlesinger refers to the debate, between laissez-faire and affirmative government, as old as

American history itself. Yet it was considered quite unanimously heretical in economic orthodoxy for the government to intervene financially in a recession or depression since the belief that market-forces would eventually correct themselves remained strong in the U.S. until the Great Depression. In fact Franklin Delano Roosevelt himself advocated strongly upon this conventional wisdom in his presidential campaign of 1932: “Revenues must cover expenditures by one mean or another. Any government like any family, can, for a year, spend a little more than it earns. But you know and I know that a continuation of that habit means the poorhouse.”

Despite his rhetoric after the election Roosevelt, upon the strong persuasion of his economic advisors, decided not to continue on the footsteps of Hoover and deliberately allowed the federal debt to pile up in order to launch the New Deal which almost solely doubled federal spending between 1933 and 1940. Nonetheless, Roosevelt remained skeptical towards government initiatives that were particularly designed for reflation and opted not to revive the economy more in 1937, which in conjunction with the contemporary monetary policy led to a stark setback in the recovery. After this Roosevelt no longer shied away from Keynesian economic management, which due to the war was about to be implemented by necessity anyhow.

To public administrations the crucial concept in Keynesian economics was that both employment and output were to a certain degree responsive to policy decisions. A clear legislative step towards Keynesianism was done after the war, when the view that peace-time would once again raise the amount of unemployed and drag the U.S. into another depression prevailed. In the Employment Act of 1946 this notion became official in the United States and the newly-founded Council of Economic Advisors became strongly connected to Keynesian theory. Additionally, the act created the JEC (originally known as the Joint Committee on the Economic Report of the President) which led some to believe that Congress would get a substantial amount of economic power due to the legislation. Ultimately, however Congress, with its JEC, gained more

---

10 Schlesinger, 241.
12 Ibid, 123.
13 Spulber, 128.
of a consultative role in economic policy while the primary responsibility stayed with the President and his CEA.\textsuperscript{14}

The subsequent presidential election where Harry Truman won Thomas E. Dewey solidified this position and made Keynesianism a faith in article. The Employment Act was a clear departure from the belief that the private market mechanism always works for the common benefit towards another belief; that man could control what he had created. Federal interference into the economy in order to \textit{correct} the cyclical functioning of the market apparatus was a notable step towards statist economic policy, which was a remarkable development in a country perceived as the figurehead of capitalism. Nevertheless, it is worth noting that the final bill that became law was a significantly watered-down version of the original full employment bill that was introduced to Congress. For example the original Senate bill stated that “all Americans able to work and seeking to work have the right to useful, remunerative, regular and full time employment, and it is the policy of the United States to assure the existence at all times of sufficient employment opportunities to enable all Americans to exercise…that right.” Whereas the final act declared that the United States would “use all practicable means consistent with its needs and obligations… for the purpose of promoting \textit{maximum} employment, production and purchasing power (italics added).”\textsuperscript{15} These slight differences in the wordings reveal the rift between the enthusiastic Keynesians and their conservative opposition.

Even at the time of drafting the question of the definition of full employment and the means how the goals set in the act would be accomplished were left vague, since the parties could not come up with unanimity regarding the issue. Therefore there was only a superficial consensus about the Employment Act and the underlying Keynesian economic philosophy that it curtailed. Despite the differences in theoretical understanding the Employment Act became law because it was more or less the symbolic legitimatization of politics that the Roosevelt administration had already undertaken in the previous decade and, more importantly, at the time it served the


interests of nearly everybody: the left saw it as an additional justification for more social spending, the political right considered it to be a useful weapon in arguing large tax cuts and increased defense expenditures, while the business sector still saw it preferable, as in the Great Depression, to minimize social agitation by decreasing unemployment. Against this historical background a powerful argument can be made (and has been made by Skidelsky\textsuperscript{16}) that the Keynesian revolution in the U.S. was, for the most part, a policy revolution where comprehension about the essential theory remained hazy at best.

\subsection*{2.2.2. After the Employment Act}

The Employment Act did not, however, lead to active Keynesian demand management in the late 1940s or the 1950s. Administrations post-1946 were not equally excited about using active monetary and fiscal policy as Roosevelt had been. Mostly this was due to the fact that the economic conditions simply did not require using it: the American economy did remarkably well following the war and the feared mass unemployment owing to demobilization never happened. Additionally the recessions of 1953 and 1958 were extremely rapid (see figure 8 in appendix 3). The Federal government reported surpluses consistently from 1947 through to 1952 despite the fact that Truman followed Roosevelt’s path to a limited extent and spent on socially beneficial Fair Deal programs.\textsuperscript{17} After the Korean War escalated and remained in a state of permanent quasi-war the newly elected Eisenhower inherited budgetary conditions that led to three consecutive budget deficits. Eisenhower, however, was not using these deficits for a Keynesian purpose to spur employment which, contrary to WWII, would have been unnecessary at the time. Instead he wished to curtail the Soviet threat by increasing military and security spending and keeping a strong military presence even after the Korean War ended. In the 1953 budget more than three-fourths of total expenditure consisted of national security programs which had increased from $17,8 billion in 1950 to $65,1 billion by 1953.\textsuperscript{18} The amount was reduced after the Korean War and became a stalemate but Eisenhower, more than his predecessors, consistently

\textsuperscript{16} Skidelsky, 2009, 103.
\textsuperscript{17} Historical Statistics of the United States: Colonial Times to 1970.
\textsuperscript{18} Office of Management and Budget; Bureau of the Budget: \textit{Budget of the United States Government for the Fiscal Year 1953}. United States. Federal Reserve Archive (FRASER). (http://fraser.stlouisfed.org/publication/?pid=54/).
kept a defense-oriented budget in place; by the end of the decade protection amounted to approximately 64% of the entire federal expenditure.\textsuperscript{19} In other words, Eisenhower bore a resemblance with the fiscal conservatives of the past who tolerated deficits for one reason alone, no matter what the economic climate, national security.

In the 1960 presidential election Kennedy made good use of Keynesian rhetoric stating that America “must adopt fiscal policies that will stimulate growth and not discourage it”\textsuperscript{20} in light of the comparatively weak economic growth of the late 1950s. Even so, upon elected Kennedy was not willing to risk his political future by doing the aforementioned in a New Deal-type of approach but instead put his faith more on a proposed tax-cut that would spur investment, growth and employment. Thus following the provisions of the Employment Act After initial hesitations, Kennedy wholeheartedly accepted the Keynesian basis for tax cuts i.e. increasing consumer demand (the supply-side argument being that it primarily endorses business incentive to invest, which Kennedy also included in his rhetoric regarding the tax-cut) and decided to propose an across-the-board tax reduction. Even this method contained political hindrances, however, and Kennedy had to struggle in order to implement this expansionary piece of Keynesian policy because the fear of a deliberate deficit in peace-time for primarily economic – and not military – advantage was intimidating for the general public. He addressed the issue in a speech at Yale University in 1962:

The myth persist that Federal deficits create inflation and budget surpluses prevent it. Yet sizable surpluses after the war did not prevent inflation, and persistent deficits for the last several years have not upset our basic price stability. Obviously deficits are sometimes dangerous – and so are surpluses. But honest assessment plainly required a more sophisticated view than the old and automatic cliché that deficits automatically bring inflation.\textsuperscript{21}

Furthermore, on December 1962 in a speech before the New York Economic Club Kennedy eloquently clarified how the deficit he was about to induce differed from previous ones:

\textsuperscript{19} Office of Management and Budget; Bureau of the Budget: \textit{Budget of the United States Government for the Fiscal Year 1959}. United States. Federal Reserve Archive (FRASER). (http://fraser.stlouisfed.org/publication/?pid=54)

\textsuperscript{20} Spulber, 66.

Our practical choice is not between a tax-cut deficit and a budgetary surplus. It is between two kinds of deficits; a chronic deficit of inertia, as the unwanted result of inadequate revenues and a restricted economy, or a temporary deficit of transition, resulting from a tax cut designed to boost the economy, increase tax revenue and achieve… a future budget surplus. The first type of deficit is a sign of waste and weakness. The second reflects an investment in the future.\(^2\)

The new administration got “America moving again” - as Kennedy had promised in his 1960 campaign - with an eight year long cyclical upswing increasing economic growth and employment while maintaining low inflation. The buoyancy was further encouraged by the acceptance of Kennedy’s tax reduction bill posthumously in 1964. The fact that the tax initiative was seized in Congress for years, before the tragic death of the President gave it the necessary momentum to gain acceptance, is further proof that the implementation of Keynesianism was far from easy in the American political landscape. Monetarist, such as future chairman of the CEA Beryl Sprinkel, emphasized that tax cuts were not efficient economic policy and that an increase in the money supply would be more effective\(^2\); critique that Keynes might very well have agreed upon, since fiscal policy was only to be resorted to after monetary policy had reached its boundaries. Nevertheless, the economic boom generated by Kennedy’s so-called “New Economics” – in truth, a modified and tax-intently focused version of Keynesianism –was bound to fail after the Johnson administration initiated large and expensive social programs, such as the Great Society, and simultaneously significantly escalated expenditure on the Vietnam War without additional tax surcharges.\(^4\)

Johnson’s resolution to pursue welfare at home and persist with a costly war abroad without increasing taxes or cutting other expenses was undoubtedly due to political considerations – Johnson’s chief economic advisor characterized it as “an escape from dogma”\(^2\) – and cannot be viewed as Keynesian macroeconomic policy, since the good economic conditions (low unemployment and little excess capacity) of the time had little resemblance with the situation in which Keynes had written *The General Theory*.

---


\(^3\) Spulber, 70.

\(^4\) Rosenberg, 103–104.

The Johnson administration was keenly aware of this as well and Arthur Okun, member of the contemporary CEA and later its chairman, said that the “principles of fiscal policy do not tell us what to do if the necessary antidote prescription for inflation cannot be filled”\(^{26}\). By this Okun was referring to the fact that Keynesian policy was confronting its political difficulties when Johnson’s calls for tax surcharges were latched in Congress. The House Ways and Means Committee declined to dislodge the necessary Tax Surcharge Bill unless federal spending was curtailed as well.\(^{27}\) In a way the Ways and Means Committee of 1967 was acting more obediently to Keynesian theory than Johnson by coupling tax surcharges with cuts in spending during boom time – although it probably did this without realizing it. But Johnson, who was burning the candle at both ends, could not grant the latter demand since he was determined to continue with the simultaneous war on poverty and communism in Southeast Asia which left no room for significant spending cuts and thus ironically also blocked his way to tax increases.

To be fair, Johnson was able to raise taxes in the summer of 1968 but this was only temporary and far too insignificant to reverse the course once taken. Aware of the political dead end he had driven himself (even within his own party), Johnson did not seek re-election in 1968 and the ostensibly fiscal conservative Richard Nixon took office.\(^{28}\) Paradoxically, the “New Economics” movement by which pseudonym Kennedy had embraced Keynesianism, failed to rein in the fiscal stimulus to stave off inflation not because it could not anticipate what needed to be done, but because the political circumstances and external events prevented it from acting accordingly. Nonetheless, the Johnson administration’s failure to implement this pull-back phase created the inflationary environment that would ultimately cause significantly more damage to the theory.

The following figures illustrate the historiographical developments of inflation and unemployment rates in the United States between the period of 1960 and 1984, and are useful to keep in mind alongside the detailed analysis presented in the following chapters. Appendix 3 contains additional graphs.

\(^{26}\) Ibid, 72.


\(^{28}\) Rosenberg, 114–116, 118.
This provides a broad historical background of Keynesian economics and policymaking in the United States before the more immediate consequences of the 1970s that further aggravated the economic challenges faced by the Ford and Carter administrations.
III: “Public Enemy Number One” – or not?

Gerald R. Ford is the only U.S. president that was not chosen to his position through an electoral victory. He became the 38th president of the United States on August 9th 1974. The resignations of Spiro Agnew and Richard Nixon created this situation and aptly depict the circumstances in which Ford was sworn into office. To understand the economic policies of the Ford administration it is necessary to point out that his political fortune was from the outset significantly damaged by his controversial pardoning of the impeached Nixon. The media, in particular, painted a negative image of Ford initially since his decision limited the meaning of unearthing the illegalities of the secretive Nixon administration, which unsurprisingly turned out to be a fruitful source of material. Unfortunately for Ford, the political image of the presidency was not the only thing left in ruins by Nixon, as the economy was also suffering in the background. Milton Friedman stated in 1974 that in the long run the Nixon’s economic decisions “will prove to have been more harmful to the nation than the misdeeds he has been responsible for in Watergate”.

3.1. Economic Legacy Inherited by Ford

“Common sense tells us that government cannot make a habit of living beyond its means. If we are not willing to make sacrifices in holding down spending, we will be forced to make a much greater sacrifice in higher taxes or renewed inflation.”

Richard M. Nixon

The accelerating inflation was initially not overlooked by the Nixon administration, which considered it to be the primary macroeconomic problem of the United States and rightly viewed them as being caused by the excessive military and social spending of

the past few years. Nixon decided to battle inflation by reigning in federal expenses and implementing tight fiscal and monetary policy. While this can be viewed as Keynesian in the respect that it partly curbed overheated demand it should be mentioned that tax increases were not part of the program. Keynesian economists of the time, such as John Galbraith, criticized the administration on the basis that it was impossible to maintain high employment with stable prices without implementing price and wage controls. Interestingly Galbraith also argued that the issue had little to do with the theories presented by Keynes since labor unions and the corporate community had gained such a strong position of power that the central government could no longer control them. The Nixon administration, which had consistently argued against government controls, replied that “the idea of freeze is illusory”.

In the 1970 Economic Report of the President Nixon emphasized the importance of stability in economic policy and that it must be done with the awareness of long-range trends. Yet when faced with an early stage of stagflation and re-election Nixon had to eventually contradict himself. The New Economic Policy (NEP) announced on August 1971, which initiated extensive price and wage controls and attempted – through gradually phased freezes – to stop inflation was blatantly inconsistent with the administration’s previous statements but was still somewhat understandable from a Keynesian point of view. However, the new policy’s calls for tax reductions to stimulate the economy were not coherent in the light of the previously tight economic policy or Keynesian theory. The policy also took the crucial step towards the end of the Bretton Woods system and the reorganization of the international financial economy: the decision to reject the dollar’s convertibility into gold.

Due to the temporary price controls, inflation was ostensibly managed and expansionary fiscal and monetary policies could be used without immediate repercussions. Nixon,

---

7 The Fact that the policy slogan was the same as Lenin’s in the 1920s can be considered either as a coincidence or a deliberate act of audacity.
8 Rosenberg, 118–119, 121.
ever the political strategist, seized on this opportunity – of a forcefully maintained inflation rate – by increasing federal spending under the Presidential elections of 1972 to pump up the economy and urged, successfully, the Federal Reserve to loosen up the money supply. The fact that the administration reverted back to austerity after the elections is further evidence that the economic initiatives done in 1971–72 were to a large degree political. Inflation came back with a vengeance after the controls were gradually lifted and the administration rapidly turned back to restrictive macroeconomic policies in 1973. ⁹

In a way, the Nixon administration had with this Machiavellian conjuring postponed the inflationary consequences beyond the election year and after further aggravation ultimately handed the problem to Ford. Moreover, by these measures Nixon had not only distorted his own economic principles, but also the public image and guidelines of Keynesian economics since the price-controls i.e. intervention by the federal government to economic affairs came to be seen as counterproductive. The fact that Nixon had famously proclaimed to be “a Keynesian now in economics” in early 1971 did little to help either. At the same time, however, sentiments towards austerity policies were also declining, which would make Ford’s battle against inflation that much more harder. For instance, the Washington Post said in June 1974 that “The Nixon drive to austerity bears all the earmarks of a bankruptcy in ideas among Mr. Nixon’s economic aides, and an inability to forecast trends with any degree of accuracy.” ⁱ⁰ This was the atmosphere in which Ford started his anti-inflation program that sought to decrease the double-digit (over 12 %) inflation left by the previous administration. ¹¹

Besides the tainted presidential image, Watergate induced to the Democrat-controlled Congress a revived sense of entitlement that caused practical difficulties for the Ford administration. This is clearly illustrated in the fact that Congress overrode a number of Ford’s vetoes and substantially altered some of his major proposals and had a significant impact on the economic policies formulated during the presidency of Ford. Congress was tired of the being left out of the loop (which Nixon was notorious for,

---


especially in foreign policy) and took pride in vigorously inspecting hitherto largely ignored aspects of the federal government that were left to the responsibility of the president.

In addition to the incoherent economic policies of the previous administrations the stagflation of the 1970s was significantly exacerbated by the OPEC oil embargo of 1973. The Arab countries that were highly influential in OPEC wanted to punish American support to Israel during the Yom Kippur War by announcing a 25 percent across-the-board reduction in oil exports. The increased international oil prices hurt the American economy badly – as the OPEC had intended – and inflation became all the more difficult to contain. This was the major external factor that to some degree justly helped the Nixon administration in downplaying its own role in aggravating inflation. The oil crisis of 1973 strongly linked economic and energy policies together, which is clearly reflected in the subsequent economic programs. For example, Ford struggled to decontrol domestic oil prices (that had been regulated during the crisis) trying to increase domestic oil production, but this program set him on a collision course with Congress that stubbornly rejected the president’s bills regarding energy decontrol.\textsuperscript{12} The fact, that Ford partially blamed Congress for extending the energy crisis with its controlled prices was remarkable because it caused a surge in public debates about the negative role government could have on the market, and while being right about this particular issue (Carter and Reagan brought decontrol in oil prices to completion, and with it increased dramatically domestic oil production and dependence on imported oil) it set a precedent that blended big government as a synonym for ineffective government. This notion would be used ruthlessly by Republicans in the future.

### 3.2. Whip Inflation Now

Starting from the beginning of September 1974, Ford hosted numerous enormous summits for the top economists and government officials of the country, trying to find a solution to the ongoing plight of the economy. The summit was originally planned by Nixon, but Ford assumed responsibility of it and formulated from its basis his first presidential economic initiative. The summits, while being largely supportive of

\textsuperscript{12} Mieczkowski, 254–255.
reducing inflation, did not find consensus on how it should be approached. *Washington Post* commented about the main-conference on inflation of September 28th: “The long succession of speakers left no doubt that, for all of the talk of overriding importance of controlling inflation, it is still the specter of high unemployment that this country fears more.”\(^{13}\) Ford, however, drew from the summits the notion that inflation was the main economic concern instead of unemployment and made the former his top economic priority in a speech before Congress on October 8th:

--- Only two of my predecessors have come in person to call upon Congress for a declaration of war, and I shall not do that. But I say to you with all sincerity that our inflation, our public enemy number one, will, unless whipped, destroy our country, our homes, our liberties, our property, and finally our national pride, as surely as any well-armed wartime enemy.\(^{14}\)

To be fair to Ford, advices from the economists were often diametrically opposed to each other representing that the uniquely high inflation had made decisions regarding economic policy that much more harder. The economic summits in September 1974 were important, since they offered a public platform for these opposing viewpoints, and depicted the wide contrast between them. Keynesian economists recommended a tax increase to people earning over $15,000 a year, while the ones closer to the Republican president, such as Federal Reserve chairman Arthur F. Burns, recommended tight fiscal policy to complement the already taken path of tight monetary policy. Ford opted primarily for the latter, where he had been leaning all along, and concentrated on cuts in federal expenditure and included tax surcharges only in a temporary form. Demonstrating his tendency towards the type of fiscal conservatism, typical to Republicans, Ford favored cutting expenditure instead of raising taxes. The decision was probably affected by CEA chairman Alan Greenspan’s notion that unemployment was less of a problem than inflation.\(^{15}\)

The program, which was coined as Whip Inflation Now (or WIN) proposed austerity – by trying to cut the budget by 4.4 billion dollars and bringing the total under 300 billion dollars – accompanied with temporary tax surcharges that would not be used to finance

---


< http://millercenter.org/scripps/archive/speeches/detail/3283 >

\(^{15}\) Mieczkowski, 114–115.
government projects helping unemployment. Instead the increased tax revenue would be aimed at reducing the budget deficit. Paradoxically, this policy proposal if suggested at the booming economic conditions in the late 1960s (with milder but more long-term tax surcharges) would have been viewed as Keynesian economic policy, since it would have constrained overheated demand by the means of fiscal policy. Yet Ford was trying to implement this policy in an economic downturn i.e. when unemployment was rising and production decreasing. With the benefit of hindsight it is easy to observe that this line of economic thinking, while hitting a chord with Ford’s economic advisors, was bound to face major obstacles in the Keynesian economic policy atmosphere still prevalent in public, and especially in the Democratic Congress. Furthermore, Ford had trouble selling the program to the section of his fellow Republicans that were heading into the congressional elections, since raising taxes even temporarily was understandably regarded as an inherently unpopular approach in the polls.  

Only a few days after Ford had made WIN-speech before Congress the JEC held a hearing in which it discussed the new economic proposal. Treasury Secretary William E. Simon defended the WIN-program on the grounds that it was consistent with the political realities of the time and underlined that the primary economic policy goal would be working down the rate of inflation. Yet Simon also reveals some mistrust in the program by stating that the administration does not consider “the program inviolable in every detail exactly as we have presented it. Quite the contrary ---”. JEC Vice chairman William Proxmire heavily criticized the program for largely bypassing the recommendations made by the committee a few weeks before which suggested revenue-raising tax reforms, tax relief for low- and middle-income persons and in general a more relaxed monetary policy. Proxmire concludes by saying to Simon that the tax surcharge “---as far as I can see achieves no useful economic purpose.”

As it turned out Ford’s initial focus on inflation subsided when it became evident that the economic downturn was gaining momentum. The recession surprised Ford in the fourth quarter of 1974 and quickly undermined the WIN-program. Ford himself explicitly stated in October that the country was not in recession but had to revise his statement to the contrary in November. Announcing the recession before the

---

16 Greene, 72–74.

Congressional elections would likely have done even more damage to the Republicans. Ford placed the blame on his economic advisors stating that “---Nobody who testified or spoke (at the economic summit) indicated that unemployment would go up as rapidly as it did”. Even though the public perception supported the battle against inflation people started to see the administration as incapable or unwilling to help the unemployed, which by the end of the year was over six percent. The pressure to use spending programs was severe but Ford would not take this course as he thought it only would increase inflation. Moreover, the economic voices – Alan Greenspan and Treasury Secretary Simon – within the administration were decidedly against this reinforcing Ford’s decision not to stimulate the economy in the perceived Keynesian sense.¹⁸

Ford regarded the Democratic approach to inflation as reckless, since they were demanding a spending program that would primarily help the unemployed, which in the administration mind would spiral into double-digit inflation. The administration treated inflation as a primary concern partly even after the recession became evident, since it viewed that inflation affected negatively the whole nation, but unemployment only affecting under 10 percent of the population was – due to simple demographics – of less importance. In other words, the Ford administration chose the neo-classical macroeconomic route that unemployment was something more or less fixed and which the government would not try to deal with, since this would only cause further damage to the economy. This attitude resembled the Hoover administration’s approach to the Great Depression, but unlike that administration Ford was better equipped to support the idea since he thought the public would regard it as responsible towards inflation. Ironically, in a Gallup survey questioned right before the 1974 Congressional election more than twice as many voters thought that the Democratic Party could do a better job regarding not only the economy in general but also inflation in particular.¹⁹ This perception was further aggravated by the unsuccessful voluntary anti-inflation campaign revolving around the WIN-program. The program became a politically embarrassing public relations campaign that eventually made the administration look naïve and amateurish in economic affairs when it asked consumers to send in their own advices on how to fight inflation despite the fact that it was done in order to incorporate the entire nation to recognize the issue, and was of only secondary importance. Alan Greenspan

¹⁸ Mieczkowski, 126–129.
later recalled that the operation was chiefly in the hands of men who knew too little of the economy and described the WIN-program as a low point in economic policymaking.20

The Democrats achieved a significant victory in the Congressional elections and under the new circumstances – economy heading into a recession, Republicans being even more distinctly a minority party – Ford had to accept the fact that WIN had become a political liability and had no chance of survival neither in the House nor the Senate. Nevertheless, the part of tax surcharges in the WIN-program came naturally as the general rise of prices pushed individuals and businesses into higher tax brackets even though their real incomes or profits had not increased. Thus federal government receipts had increased more than projected.21 In the newly invigorated recessionary climate President Ford had to come up with an economic policy that would boost the general economy yet still keep inflation intact. This, however, would not be easily achieved since the Republican president and Democratic Congress could not reach a mutual understanding when faced with stagflation.

### 3.3. Choosing Between Austerity and Tax Cuts

With the WIN-program Ford had taken a strong stance against federal spending linking it closely to inflation, which was pronounced as the nation’s first priority. Within a few months this priority had to be changed due to the economy’s performance in the last quarter of 1974. This revision in policy was made official in the ERP of 1975 where Ford stated that the most pressing concern of policy is to halt the decline of production by increasing output and reducing unemployment.22 In the 1975 report released in January 1975 Ford and his CEA illustrated their change of direction from WIN most concretely when they proposed a tax relief initiative – through amongst others a tax rebate –totaling approximately $12 billion. Additionally, the administration aimed to

---


reduce inflation by the means of an energy program that would minimize the effects that
the rapidly rising oil prices had caused. On the other hand Ford was not willing to
increase federal expenditure in order to ease the economic situation “because of concern
that a too expansionary budget carries the risk of worsening inflation”. 23

Accordingly Ford was not about to contradict himself in relation to his philosophy on
federal spending. He was not able to turn the tide completely, however, and settled
proposing in the report that a slower rate of increasing public expenditure would do for
now. 24 Cutting taxes was therefore a more pragmatic policy choice in the altered
situation and a reversal on this issue could relatively easily be justified to the American
public. Ford and his economic team rationalized the tax cut as a way of fighting the
recession without igniting inflation. To the displeasure of Democrats, Ford maintained
that the reversed tax policy would still be accompanied by simultaneous and continuous
cuts in federal spending. In a way Ford wanted to implement governmental austerity yet
ignite consumer spending. He was unwilling to perform a tax cut in the Keynesian
sense, which would have financed the tax cut in a recession by a budget deficit and
catch up with it during the eventual uptrend, but in part he succumbed to the pressure by
allowing the deficit to be bigger than originally planned.

Compared with the Kennedy administration tax-cut in 1960s, which was aimed at the
fact that (due to economic growth) government revenue could be reduced in order to
increase employment, the program recommended by Ford and his administration
thought that a tax cut would, aside from the employment objective, limit government
spending. Additionally, according to the supply-side economists who had the Ford
administration’s ear a tax cut would also have positive effects on incentives, investment,
and the expansion of supply of goods and services. This is evident in the ERP since it
states that the proposed tax cuts will give “businessmen an incentive to undertake some
investment now that they would otherwise have undertaken only later.” 25 It is important
therefore to discern that the sales pitch of this tax cut was markedly different from the
one implemented by previous administrations that focused primarily on consumer
spending and not business incentives. The Ford administration on the other hand linked
them together possibly as a medium to better justify its turnaround.

23 Ibid.
The details about the program had already been revealed slightly before the ERP of 1975 in Ford’s State of the Union Address in January 15th 1975. In it Ford announced that the administration’s new economic program would be the center of focus of his first full year as President. In a televised speech two days prior to the State of the Union address Ford had tackled the problem of flip-flopping on economic policy head-on:

---the situation has changed. You know it, and I know it. What we need most urgently today is more spending money in your pockets rather than in the Treasury in Washington.26

What is noteworthy here is that Ford had performed a fundamental volte-face, since he was now promoting consumer spending while only a few months back he had encouraged economical behavior from consumers (and even asked for their advice on how to accomplish it). In the State of the Union address Ford proposed a $16 billion temporary tax cut to boost consumer spending coupled with restraints on federal spending to control the deficit and inflationary pressures the program might entail. The New York Times praised the political courage Ford displayed in admitting that a change in course was necessary and that he had been misguided in his earlier economic program. Yet, the same article notes that Ford seemed less sure of himself compared to the initial endorsement of the WIN-program – an indicator that Ford was not that comfortable proposing more consumer spending by the means of a tax cut, which undoubtedly was partly performed to please the Democratic Congress.27

Ford fell short on his attempt to please the Democratic Congress and to boot harmed his popularity with the fiscally conservative wing within his own party. The Democrats deemed the tax cut, while itself being a good thing, as insufficient. The JEC’s 1975 economic report emphasizes that the tax cuts should be coupled with increased public spending. Nevertheless, the JEC pointed out that this did not mean permanent government programs but one’s of temporary nature designed to phase out as a better level on employment would be achieved.28 On the other hand, the conservative Republicans were disappointed that Ford was willing to yield so much regarding the

deficit. Ford was frustrated by these issues which he saw as excessively partisan policies.

Democrats reworked Ford’s tax cut proposal in Congress and improved it by directing it mainly to lower and middle-income taxpayers, who were more likely to spend the additional money and therefore substantiate the influence of the intended stimulus. Furthermore, the Democrats controlling the process in Congress decided unsurprisingly, but to the irritation of many Republicans, to increase the amount of the tax cut from $16 billion to $22.8 billion which Congress ultimately approved on March 26th. Between the initial tax cut proposal and approval of the bill in Congress, Ford had emphasized extensively the need for quick action, and partly because of this he saw that vetoing the bill would make him seem like a hypocrite. The economic advisors of the administration encouraged Ford to sign the bill, but urged him to accompany his signature with a strong statement for fiscal restraint – conceivably to save his face if inflation would get out of control due to the bill. Ford signed the Tax Reduction Act of 1975, but made clear his fundamental fiscal philosophy by criticizing the fact that his proposals to apply austerity to federal spending were ignored during the formulation of the bill.  

The effect of the bill was initially largely positive mostly as a public image victory of actually doing something concrete about the economy. During the summer of 1975 unemployment did not drop significantly and Ford contemplated another even larger tax cut. The administration had been thinking of linking tax cuts and federal restraint more firmly already in the beginning of 1975, but the idea did not materialize in the Tax Reduction Act signed on March 1975. By October 1975, however, the administration announced a new tax cut program that consisted of a commensurate cut in spending. Ford proposed a $28 billion tax cut that would also cut spending by the equivalent amount. This time Ford emphasized that curbing the growth of federal spending was an essential part in enabling future tax cuts. Treasury Secretary Simon commented to newspapers that the proposed fiscal package confronted Congress with “a classic choice between freedom and socialism.” Linking federal spending to socialism (and by this logic Keynesianism to socialism) was an obvious appeal to the Cold War atmosphere where socialism in the United States was associated readily with communism.

---

Yet, newspapers including the *New York Times* were quick to notice that the proposed second round of tax cuts were to take place in January 1976 while the spending cuts would occur only after the November 1976 presidential elections.\(^{30}\) The media (and the Democrats) readily observed the possibility that Ford was planning to do the type of politico-economic sleight of hand as Nixon had done back in 1972. To be exact, this was not the case in Ford’s program since it would not have kept inflation under control until the elections as Nixon had been able to do with the price-and-wage controls four years earlier. Democrats focused additionally to the fact that the new proposal did not specifically mention what programs would eventually be cut in order to meet the targeted $28 billion. Congress was not willing to give the president the control to put down their programs without proper grounds, especially when it found out that part of the cuts were to come off from food stamps and other social programs.\(^{31}\) A vaguely defined objective of cutting government expenses was not acceptable to Democrats.

The JEC held a hearing in late October 1975 to discuss Ford’s new tax cuts and the expenditure slashes that the proposal entailed. In the hearing JEC chairman Hubert Humphrey discussed the fact that the proposed economic program by the administration would not make the tax and spending cuts concurrently and enquired aggressively from Greenspan about the program’s political consequences (appendix 2 contains an excerpt from the hearing’s official record and reveals the animosity involved). Humphrey was additionally amazed by the fact that the administration had continuously pronounced the evil of deficits by emphasizing the excessive outlay side of the budget but was willing to propose tax cuts that would now add on to the deficit by reducing the revenue side:

> For the life of me, I cannot understand what is going on. You deplore the deficit. Then you say, let’s add on to it even though it is undesirable. You say, we have a substantial recovery and you point out that you do not really need any further tax cut for recovery, so you propose a bigger one than anybody else has proposed. It is sort of like the convert that becomes a true believer---\(^{32}\)

The JEC was strongly of the point of view that the administration’s new position was based more on political reasons than economic. From a contemporary Keynesian


\(^{31}\) Mieczkowski, 180.

macroeconomic viewpoint the administration was proposing a more or less futile gambit, because the two cuts would ultimately cancel each other out, causing its net effect to be little to nonexistent. This notion broadly supported by Democrats – along with skepticism where the spending cuts would take place – produced from Congress a bill that proposed tax cuts of $17 billion (12 billion less than what Ford had proposed), but ignored the spending cuts that Ford had passionately advocated as a part of his economic policy thereby making the initiative more reflationary in aggregate. Ford quickly vetoed the bill but after further revision had to settle for a symbolic victory; federal spending was not tied down to a specific limit according to the equivalent of the tax cut as Ford had originally proposed, but instead Congress inserted a rather vaguely put promise of budget control into the revised bill. Despite the fact that Congress had for the first time officially agreed that there must be some limit to federal spending, Ford had again failed to implement practical austerity to the government.

The tax cuts, which took place in 1975 and the beginning of 1976 were conservatively Keynesian in the sense that the program was financed by the public deficit and aimed to improve employment and aggregate demand. They should be viewed as conservative because of the perspective that Keynes in his original theory argued that spending money on the economy would be a more direct way of helping the economy as a whole than cutting taxes, which would be an indirect manner. He based this on the fundamental psychological law that “--men are disposed, as a rule and on the average, to increase their consumption as their income increases, but not by as much as the increase in their income”. Therefore – according to Keynesian macroeconomic theory – tax reductions while they increase the propensity to consume do not increase aggregate demand as much as for instance, government construction programs. Furthermore, the aforementioned economic programs could not be perceived even as conservatively Keynesian, if the Ford administration would have had its way with the equivalent expenditure cuts it adamantly demanded in the fall of 1975 in relation to the second round of tax cuts.

In addition the tax cut programs of 1975-76 come into a strange light with regards to the theory, if Keynes’ argument of the zero lower bound interest rate is taken into account.

34 Keynes, 1936, 96.
According to the *General Theory* fiscal policy comes forcefully into play only after monetary policy has lost its appeal: in the case of a recession this means that the Federal Reserve would have lowered interest rates to a level where credit markets relaxed. This is quite logical since typically in the early stages of a recession interest rates decline e.g. in the Great Depression interest rates were steadily quite low. Yet in 1970s this did not happen. Interest rates were kept relatively high most likely because of the tenacious anticipation of elevated rates of inflation. Therefore inflation itself prevented Keynesianism to work according to the theory, especially as price and wage controls were lifted.

### 3.4. Fiscal Policy Preceding the 1976 Elections

“We must not continue drifting in the direction of bigger and bigger government. The driving force of our 200 year history has been the private sector.”

— Gerald R. Ford

Statistics reveal that the unemployment rate (8.3 % in 1975) was steadily decreasing to levels near 7 % in 1976. The recession seemed to have peaked in 1975 and was coming down, but unfortunately for Ford this was happening too slowly considering the upcoming elections – where the employment issue would play an important role. Remarkably inflation was also easing, even though Ford’s repeated warnings of the nearly inevitable inflationary consequences of performing tax cuts without implementing equivalent spending restraint were practically ignored. Presidential historians as well as economic historians (such as Miekzkowski and Samuel Rosenberg) have credited Ford’s austerity outlook and tough attitude towards government spending for the drop in inflation experienced during 1976, but peculiarly unobserved seems to be the fact that Ford’s spending restraints never materialized in practice. Instead they were bypassed by the Democratic-controlled Congress, which demanded more economic

---


activity, such as a 6 billion dollar program providing federal money for government and municipal buildings (which can be viewed as a purely Keynesian economic policy initiative) but were consistently vetoed by Ford. To be fair, the administration did shut down some programs thus saving taxpayer money and presenting that on some level the austerity rhetoric was implemented. However, closing for example existing military bases (that were already seen as useless) cannot be credited for markedly halting inflation.37

In the 1976 Economic Report the CEA and Ford emphasized that unemployment was a problem that they certainly did not undermine but warned that “policies that might speed the decline in unemployment in the short run should not be so expansionary as to lead to increased instability and greater social hardships in the long run.” Furthermore, in the report the administration offered a quite persuasive argument why it chose to follow discretionary fiscal policies: “we must be mindful of the great difficulties in executing countercyclical policies”.38 Thus Ford and his CEA were not entirely abandoning the basic idea of Keynesianism but were willing to pursue it only with extreme caution. The administration’s economic plan in the election year of 1976 included maintaining the tax cuts previously decided upon to stimulate the economy while curtailing the growth rate of public expenditure – not actually reducing it. Ford the fiscal conservative had been forced by Congress to act in a mildly Keynesian manner. Nevertheless, it was the administration’s balancing between the middle – characteristic to its other policy areas as well – that left both of its flanks in the political spectrum open for attack. The right thought that Ford was pleasing the Democrats too much, while the left believed that he was thwarting economic recovery by hindering Keynesian policy initiatives.

Ford who at least rhetorically possessed severe disdain for the federal government already was considered to be too moderate by the conservative wing of GOP. In fact Ford had by this time tried to please the Republican right by persuading his Vice President Nelson Rockefeller, a known moderate, to remove himself from the 1976 ticket. Yet the resentment against Washington was so strong among the conservative flank that Ronald Reagan was able to surmount a considerable battle for the Republican

37 Mieczkowski, 191.

nomination by using anti-Washington rhetoric that intensified noticeably the attack against big government. Even though the central issue debated in the primary was foreign policy – the neoconservatives claimed that Ford had been soft on national security – Reagan was also pointing a blaming finger towards Ford’s economic policy alignments as being too weak. In a televised speech Reagan stated that “the fact is that we, we’ll never build a lasting economic recovery by going into debt at a faster rate than we ever had before”\textsuperscript{39}.

The Joint Economic Committee report on the Economic Report was littered with harsh criticism towards the direction of economic policy that the administration kept on pursuing. The following citation from the reports summarizes the Democratic sentiment toward Ford’s fiscal conservatism:

We expect improvement in economic performance in the next several months, but we are very concerned that the President’s restrictive 1977 budget, if accepted, would remove the supports from beneath the recovery at a critical time. Unless economic policies are substantially more stimulative than the administration proposes, the recovery could founder in 1977.\textsuperscript{40}

Therefore it is not surprising that the Democratic Platform for 1976 advocated economic policies that would invigorate the employment rate by applying coherent economic policies focusing on public work projects, grant programs to state and local government and a direct stimulus to the private sector. The elected nominee, Jimmy Carter, supported the platform wholeheartedly at the time and in a debate against Ford raised putting people back to work as his top priority. Carter and the Democratic Party were arguing for a purely Keynesian economic policy that would concentrate both on increasing public expenditure and keeping the philosophy of tax cuts in place (even though Carter proposed that a tax reform was needed in order to direct the tax base more towards the upper income-levels and corporations). The possible inflationary consequences of these policies were to a certain degree disparaged and inflation itself was credited to stop-and-go monetary policies that kept interest rates relatively high for

\textsuperscript{39} (A claim that was true only in nominal terms disregarding inflation) Farney, Dennis: Reagan hits Ford Policies in a Televised Speech Says Recovery Could Lag After Election. The Wall Street Journal, April 1\textsuperscript{st} 1976.

a recession and Republican reluctance to assert any controls on price and wage levels.\textsuperscript{41} The Joint Economic committee, controlled by Democrats and chaired by Hubert Humphrey, suggested in its midyear review of the economy that “serious consideration be given to (among other things) tax cuts in 1977 for individuals and corporations”. The review echoed the Democratic platform in requesting public spending on jobs programs and manpower-training efforts.\textsuperscript{42}

As the result of the 1976 presidential elections shows, the electorate did not credit Ford for the gentle economic recovery, but saw that – with his multiple vetoes – he was actually obstructing the economy from significantly improving. Jimmy Carter utilized this in a televised debate against Ford when discussing about the economy: “Mr. Ford so far as I know, except for avoiding another Watergate, has not accomplished one single major program for this country.”\textsuperscript{43} This obviously implied to the fact that the economic programs that were carried through during the Ford presidency were largely compromises between the Democratic Party and Ford – usually favoring the former. In his presidential campaign Ford decided to advocate the unswerving economic policy formula of his administration consisting of tax cuts alongside balanced budgets, while Carter focused solely on solving the unemployment issue. Although, Carter’s approach proved successful and with it indicates that Keynesian policymaking still had substantial popularity among the American constituency in the mid-1970s, it is worth noting that Ford’s low-taxes – combined with private market ideology – approach gained momentum and would prove wildly successful four years later in the hands of Ronald Reagan.

Before leaving office Ford’s CEA, personified by its chairman Alan Greenspan, published its last annual report in which it strongly advocated for permanent tax cuts in favor of increased government expenditure. The CEA argued that this decision had more to do with political than economic factors since lowering public expenditure had been proven to be difficult. This was an obvious reference to the late 1960s when Johnson had trouble reining in federal expenses after the Kennedy tax cuts had achieved

\textsuperscript{41} Democratic platform 1976; Presidential Debate September 23\textsuperscript{rd} 1976.


\textsuperscript{43} Ford vs. Carter I: President stresses tax cuts, challenger more jobs, goals that mirror candidates differing philosophies. \textit{The Wall Street Journal} September 24\textsuperscript{th} 1976.
the economic uptrend it targeted. Furthermore, tax cuts should be made permanent because according to the CEA “if taxes are not reduced periodically we run the risk of allowing the tax burden to rise over time and thus inhibit the growth of demand in the private sector”.\(^{44}\) In his last hearing before the JEC in January 19\(^{th}\) 1977 Greenspan accentuated that tax cuts were a more preferable way to stimulate the economy than spending programs since increasing expenditure would not solve the underlying structural unemployment problem of the economy, which according to Greenspan was largely due to women and youth being able to move in and out of the labor force more rapidly than before.\(^{45}\)


IV: Carter Administration’s Economic Policy Alignments

“We Democrats still agree with Harry Truman that full employment is, and ought to be, a national policy and a national goal – and we ought to pursue that goal with all the determination and imagination we can muster.”  – Jimmy Carter in a campaign proposal to the Democratic platform in 1976.

Jimmy Carter’s presidency is often described as inefficient and economically at odds with Congress finally bringing down the Keynesian macroeconomic thinking in American politics by increasing inflation to new heights. The new president came outside of Capitol Hill having no previous experience from Washington, but only from his native state, Georgia, where he had served as governor from 1970 to 1974. Consequently in his 1976 campaign Carter had taken advantage of the fact that he would come into the White House as an outsider and promised to restore trust and honesty in government. Yet, during his four-year presidency this trust in particular came under attack from the opposition and ultimately destroyed his chances to get re-elected.

4.1. Campaign Pledges, Initial Programs and Changing Course

Despite emphasizing unemployment issues against Ford in the presidential campaign, during the primaries Carter was the most fiscally conservative nominee of the Democratic Party. In the spring of 1976, when the race for Democratic nomination was at its peak, Carter significantly differed from his opponents by being openly skeptical about the possible inflationary consequences that a large-scale government employment program might entail. The fact that Carter was not the strongest advocate of Keynesianism to begin with should be kept in mind when evaluating his subsequent economic programs as president. He was the most conservative (i.e. conformist to classical economic theory) of the Democratic candidates in the 1976 campaign, which

later logically resulted into a number of conflicts with the liberal Democrats occupying Congress but during the presidential race itself this side of fiscal conservatism was hidden in order to appeal to a larger voter-base. This is not to say that Carter deceived his voters, he might have genuinely believed in the practical issues involved with Keynesian economics at the time, but still had an undercurrent of fiscal conservatism. Once in office however Carter to some extent re-evaluated the traditional priorities of the Democratic Party concerning the economy (i.e. employment and the welfare state) after a short honeymoon with Congress. He could not hold onto the economic principles which had prevailed in his party since the Great Depressions, largely due to the strong inflation that reappeared in the latter part of 1970s and climaxed in the election year of 1980.

After being elected president Carter and his economic team started swiftly to work on an economic program that would fulfill the promise of reducing unemployment – from above 7% to roughly 4% of the workforce – made during the campaign. The fact that Carter had bound himself to a specific number was at the same time politically courageous and careless. It left little room for ambiguity and made the administration’s economic initiatives extremely vulnerable to the examination of the press. A forerunner in this field had been the Kennedy administration which successfully quantified its employment target to 4 % in 1960. Before being elected Carter commented on an interview that there was not a significant risk of inflation until the unemployment rate went under 5 %. What originated from this promise in the beginning of 1977 was a program largely committed to Keynesian doctrine, which can be viewed as a rather unsurprising development considering the emphasis on employment made during the campaign. Carter decided to continue with the tax cuts Congress had made with Ford for the past few years, but unlike his predecessor and the advices of his CEA, accompanied them with increases in government expenditures. Thus at this point we can observe that Carter was originally willing to execute Keynesian doctrine even though he had reservations towards it that would subsequently materialize.

In the beginning of 1977 Carter was still for the most part in sync with the Joint Economic Committee, which after the elections had changed its role from providing rough partisan critique to that of a calm persuader. In its 1977 report the committee’s

---

5 Biven, 2002, 36.
new chairman, Democratic Representative Richard Bolling, applauded the administration’s initial economic program as a good sign for the economy, especially since it acted quickly and constructively. Nevertheless, the Committee’s Democratic majority declines a connection between worsening inflation and reflationary demand management: “…worsening of the inflation rate will be in no way related to adoption of the stimulative program and does not constitute a valid argument for increased caution in bringing unemployment down.” The panel’s Democrats validate the volatility of the inflation rate by pinning it on rising food and fuel prices that cannot be curtailed with the limitation of demand.6 Furthermore, the committee majority highlights the already visible differences of opinion between itself and the CEA on the issue of what the unemployment rate target for public policy should be.

On the other hand the views expressed in the minority section of the 1977 report (which account for half of the entire report) emphasize the need to underscore the role of the private sector and criticize the content of the economic stimulus underway. According to the minority view the stimulus should be solely made of permanent tax cuts and especially not public expenditure due to the argument that government intervention will only substitute private activity with a public one.7 The Republican minority view therefore takes the debate of economic policy back to the fundamental of government involvement in the economy. Interestingly it also expresses a more technical argument against Keynesianism by quoting a study of Martin Feldstein in which he stated that the cause of unemployment “is not insufficient demand. As a result, the traditional Keynesian policies of increasing demand would not only fail to achieve a sustained recovery reduction in unemployment, but would again ignite an inflationary chain reaction.”8

The clearly Keynesian economic policy initiative in the beginning of 1977 was later enhanced by approving higher spending on public works. The two-year program was designed to help the economy immediately with tax cuts and additionally with public programs scattered over the next few years. However, the original vision of the program was revised by reducing the amount of the stimulus package by $10 billion. According

7 Ibid, 68–69.
8 Ibid, 71.
to the *New York Times* this was largely because Federal Reserve chairman Burns strongly ridiculed the economic program Carter at first proposed. One major consequence was that rebates on taxes ($50 per individual) that Carter had proposed – as a major part of the economic program – were rendered as unnecessary and therefore cancelled in April 1977. In practice the entire tax cuts of the program were to some degree offset by practical increases in payroll taxes since inflation pushed people into higher tax brackets. The level of public expenditure was also criticized as inadequate. It is telling that two hours after Carter signed the stimulus bill in May 1977 – which among other things gave $7.9 billion for public service jobs – mayors of the cities that had been given the subsidies attended an economic policy forum and issued a statement where they proclaimed the stimulus only as a necessary first step that needed to be accompanied with similar initiatives in the medium term.

Carter was initially quite liberal and aggressive in his economic policy and consequently unemployment dropped to 6.1% by the beginning of 1978. On the other hand, inflation started accelerating rapidly as Ford and his economic advisors had warned during the presidential elections. The president and his CEA – contrary to the Joint Economic Committee – rapidly leaped to the conclusion that increased federal *spending* had a stronger correlation to inflation than he previously had thought and neglected the notion that increased prices were not a risk before unemployment was under 5 percent. Thus Carter started to reverse his focus from managing the employment to controlling inflation early on, which the cancellation of the tax rebates clearly illustrates. The first truly Keynesian economic policy program during stagflation was significantly undermined before implementation for the fear of inflation, and was not that liberal to begin with. For example, Burns contently stated on February 1977 that Carter had “--put together a fiscal package smaller and more prudent *many had urged upon him*” (italics by author). It is therefore crucial to note that the liberal Democrats in Congress still did not get the Keynesian economic program they had been demanding since the fall of 1974, even though a Democrat was occupying the White

---


10 Campagna, 422-425.

11 Ibid., 437–439.

House. The problem for them was that Carter while being liberal in his foreign and social policies turned out to be determinedly conservative when it came to fiscal policy in the eyes of the liberal Democrats – at least when he cancelled the tax rebate. Carter received loud public criticism from fellow Democrats, such as George McGovern who accused the president for practicing “Republican economics”. While McGovern’s verbal attack was indeed exaggerated, since it was done before Carter had even made a distinct turn towards fiscal conservatism, it exemplifies the fact that Carter’s middle way was causing disunity within his own party. Yet it could not gain support from the Republicans either. Carter’s economic policy quickly started to reflect that of his predecessor, and McGovern ironically added to his criticism that “In reviewing economic policy this spring, it sometimes seems difficult to remember who won last fall.”

The 1977 midyear report of the JEC clearly illustrates the widening rift between liberal Democrats and the administration. Considering the fact that it was controlled by the same party as the White House the report’s sentiment reveals a striking amount of bitterness and disappointment. Direct fire was aimed at the Federal Reserve, most likely because of its chairman’s role in removing the tax rebates in Carter’s initial stimulation program. The report states that the Federal Reserve should be forced into respecting the economic goals of White House. Additionally, the report takes a strong stand against the perception that public policies run financially amok: “It is obsolete and much too costly to preserve the antiquated fiction that politicians are irresponsible spenders in consequence of which an authoritarian central bank is required as a last line of defense against inflation. A last line of defense against unemployment needs to be given similar priority.”

In addition the report stated that Congress with a new budgeting process started in 1974 has shown the capability to exercise fiscal policy responsibly. This statement had a lot to do with the fact that the Carter administration was progressively emphasizing budget balance in 1981 as an economic policy goal which liberal Democrats interpreted as an alarming sign since stimulus was not being provided extensively enough to anticipate an

---


economic upswing in their mind. The disagreement is evident in a JEC hearing of CEA chairman Charles Schultze in June 1977 where Bolling voices his concern that a balanced budget by 1981 (“...come hell or high water”) should not be a goal in itself and judged that the administration strategy in this regard resembled a wish – not an actual plan.15

4.2. The Humphrey-Hawkins Act

In October 1974 Hubert Humphrey, former vice president and presidential nominee, presented a new bill to the Senate with its aim to renew and modernize the employment promises made in the Employment Act of 1946. The ambitious bill aimed to quantify the unemployment rate to 3 % and achieve this within 18 months of passage.16 Importantly it can be seen to represent the contemporary JEC’s economic policy alignment, at least for the liberal Democratic sector, since Humphrey was JEC chairman during the 94th Congress (1975–76). Representative Augustus Hawkins introduced a similar bill than Humphrey in the House, but both of the legislative initiatives stagnated in Congress for years. Not least because of the aura of budget cuts and general fiscal restraint that characterized the Ford presidency.

In 1976 the bill got new life to it when Carter became President. It was already on its way to becoming a law, but by this point it had been revised and toned down remarkably. The original bill which demanded government to be the “last resort” of general employment (which would have authorized chronically unemployed to sue to compel such employment) had been taken away and specific programs designed to lower the unemployment rate had been mitigated due to political opposition stemming from the Republican Party. Interestingly, the original version also specifically forbade the President to sacrifice the cause of lowering unemployment for the fight against


inflation. Yet the so-called Humphrey-Hawkins bill maintained its two fundamental ideas: full employment and more coordinated national economic management behind it. Both of these ideas reflect the strong Keynesian undertone that the bill originally contained.

In the 1978 ERP President Carter does not highlight the Humphrey-Hawkins bill as a possible solution to the nation’s economic woes, but instead makes a particular argument that the private sector must be the one that creates new jobs and leads economic expansion – one of Carter’s four main economic objectives mentioned in the report. As a justification Carter uses the fact that five out of every six new jobs is created in the private sector, a fact that Ford had previously used in his Budget Message of 1977 for the exact same purpose. Nonetheless, Carter does offer his general support for the legislation and hopes that Congress will enact it. When discussing the Humphrey-Hawkins bill the CEA concentrates on the complementary effect that the possible law would have for the President, since it offers him the justification to maintain price stability by a variety of means (in the original version these were included so that the President could more easily abandon inflationary obsession for the purpose of promoting employment during times of trouble). The CEA clearly focuses on the inflation-related aspects of Humphrey-Hawkins in its analysis of it and raises a skeptical voice to its final objective of 4% unemployment rate (also a compromise from the original 3%): “Given the present structure of the markets, it is unlikely that a 4-percent unemployment rate could be achieved through aggregate demand policies alone without at the same time causing a significant increase in the rate of inflation.”

In its 1978 annual report the JEC was clearly divided on two issues both of which had a connection to the Humphrey-Hawkins bill. For starters liberal Democrats considered Carter’s budget proposal for fiscal year 1979 too lean and ignorant to the needs of American jobless and farmers. In a congressional hearing JEC member Sen. George McGovern told Shultz (who had lambasted the Humphrey-Hawkins bill in public), that the $25 billion tax cut that the administration had proposed for 1979 should instead be

---

19 Ibid, 95.
targeted to public investments which would act as a direct stimulus to the economy and thus be more efficient than a tax cut. Liberals were additionally angered by the fact the proposal was increasing defense spending and asked for relatively small increases in other areas (barely covering inflation) despite Carter’s campaign pledges that he would trim defense expenditure by $5 to $7 billion annually. Republicans on the other hand severely criticized the proposal arguing that its conservative rhetoric was a Trojan horse designed to hoax the public into believing that the deficit would be under control while the proposed budget would in fact, according to House Minority Leader John J. Rhodes, “swell our deficit far above its current level like rice in boiling water.”

The JEC report also urged controls on wages and prices for the coming year in order to slow down inflation if the situation would not improve. This warning by the Democratic majority of the JEC was not even supported by the committee’s Democratic vice chairman (and soon to be chairman) Lloyd M. Bentsen who stated that restrictions were in any case an illusionary way of fighting inflation that would not work during peacetime. Heralding the shift that the JEC would take under his leadership Bentsen – in a personal commentary released in the Wall Street Journal shortly after the JEC’s annual report – concluded that inflation would be subdued after reducing excessive government regulation of business and the federal budget.

The Humphrey-Hawkins procedure also inspired the JEC to reconsider its role regarding the economic policymaking process. JEC chairman of the time Richard Bolling proposed during the House consideration of the bill that in the future the committee could act not only as the congressional watchdog for economic objectives, a part it had established after the Employment Act, but also in a more vital role in the making of economic policy in general. Bolling wanted to amend the bill in a way that would have left the House and Senate Budget Committees with little role in determining broad economic goals, making them more dependent upon the economic guidelines provided by the president and moreover the JEC. The suggestion was quickly killed in the floor and severely ridiculed by the (conservative) media which feared that the

---


traditionally liberal JEC, if legislatively powerful, would create an economy in which everybody worked for Uncle Sam.

Amongst the negative attitude towards the bill, of which the administration’s economic advisers were certainly not the sole perpetrators, Richard Bolling presented a public letter, titled “the Best Hope for moving out of Stagflation”, to the New York Times in which he defended and clarified the objectives of the bill. Bolling argued that despite the structural challenges facing the economy of which there seems to be general consensus there is a lack of “sufficient cohesiveness and coordination” in fiscal and monetary policy and that these deficiencies ultimately promote the lack of success in the management of the economy that the government has been having. “Far from setting visionary goals, the bill reaffirms the 1946 dedication to full employment.”

Interestingly Bolling was not defending the bill only because of its implied Keynesian principles but also because it was perceived to help in the supply-side problem of the economy by possibly making changes in that sector more feasible. This was signaling the future of the committee itself; after failing to get a more powerful role in economic policy through the Humphrey-Hawkins bill, which the committee’s Democratic majority had persistently supported, the JEC quickly started to seek new ways in which it could be heard. Its political status changed remarkably in the following years not because of a changed role but because the committee’s message concerning economic theory became markedly different.

On October 1978 Carter signed the bill, after extensive negotiations between its supporters and the White House, but used the occasion not to promote the cause of unemployment but to emphasize the importance of curtailing inflation: “Success in fighting inflation is critical to success in fighting unemployment.” The fact that Carter undermined so strongly the original vision of the Act is a clear indication that he had lost faith in the previously sacred goal of unemployment that Democrats had valued since the Employment Act and turned towards economic policy that made anti-inflation the main target of government intervention – to be achieved by government extraction.

The bill, which was consecrated by the official name Full Employment and Balanced Growth Act of 1978, became in hindsight more of last symbolic stand against

unemployment than a concrete solution. Moreover the fact that Humphrey-Hawkins quantified its goals and aimed to accomplish its target rates within the next few years made it seem almost absurd to the economic conditions of the next decade and it was forgotten into the dustbins of economic history. Arguably the emphasis towards anti-inflation had a lot to do with it, especially when coupled with the addition of the new macroeconomic paradigm of the 1980s, which with its neoclassical stoicism reverted back to the conclusion that government was not directly able to control employment rates.

4.3. Embracing Austerity

“It is my strong conviction that inflation remains the Nation’s number one concern.” - Jimmy Carter

In the light of increasing inflation Carter was forced to change course in midstream, much like Ford had done in the winter of 1974 but this time instead of reversing from anti-inflation to recession programs it was to the opposite direction. Carter moved fiscal policy towards austerity and cut federal expenditure by 12 billion dollars already by the end of 1977. But because the liberal Democrats were not going to allow major fiscal programs leaning on austerity it was tight monetary policy that got the lead role in holding down price increases. In particular the appointment of an arguably monetarist chairman to the Federal Reserve in Paul Volcker made monetary policy focus more directly into controlling inflation by regulating bank reserves as Friedman had encouraged. This disregarded completely the JEC which still in its 1978 report had proclaimed that the economy ought to be stimulated primarily through expansionary monetary policy which still echoed the Keynesian doctrine of first using a relaxed monetary stance when encountering an economic downturn. Carter not only ignored this advice but also started to pronounce fiscal austerity rhetorically, forecasting a decade-long struggle against inflation and warning in the fall of 1978 that the budget for next

---


year would disappoint those who expected constantly increasing numbers of federal programs and agencies.\textsuperscript{26} Besides the fact that Carter was proposing budgetary restraint he also took a peculiar turn, at least for a Democrat politician, by pronouncing that government was not only the problem of the contemporary economic woes but also primarily unable to solve it (strangely contradicting the basis of his own austerity policy). This became evident in his State of the Union Address of 1978 where Carter pronounced notions of government that were in vivid contrast to the one’s he proclaimed preceding the election – and to any Democratic President since Roosevelt:

Government cannot solve our problems. It can’t set our goals, it cannot define our vision. Government cannot eliminate poverty, or provide a bountiful economy, or reduce the inflation or save our cities or cure illiteracy or provide energy. And government cannot mandate goodness.\textsuperscript{27}

Nevertheless, Carter did not abandon the option of tax cuts – despite their initial setbacks – and the administration proposed further tax reductions to provide necessary stimulus to reduce unemployment near 6 percent, but these were later curtailed due to the fear of increasing prices.

Carter had been convinced that inflation was the country’s top priority and stated in the 1979 ERP that “reducing inflation will require budgetary austerity and moderation of economic growth”.\textsuperscript{28} In the same report the CEA reported that future social policy had to be guarded within the limits of the budgetary control, an obvious innuendo to the butter and guns policy pursued by the Johnson administration. There was no doubt that inflation had become the most important economic priority for the administration despite the fact that a revision of the Employment Act had just been signed three months before. Yet it was difficult for a Democratic to make the austerity case in a situation of high unemployment and Carter tried not to anger the liberal wing of the party too often which caused frustration and confusion among the president’s economic circle. For example, Carter ultimately had to fire his treasury secretary Michael Blumenthal who was too vocal in his anti-inflation argumentation. After being fired in

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{26} McBee Susanna: Carter Delivers Austerity message to cities’ leaders. \textit{The Washington Post} November 28\textsuperscript{th} 1978, A2.
\item \textsuperscript{27} Carter, Jimmy: State of the Union address 1978.
\end{itemize}
\end{footnotesize}
1979 Blumenthal criticized the administration for “an effort to fight inflation but not too hard. It was tighten the belt but don’t cut out any important programs: cut down on government regulation but don’t offend any special interest groups.”\(^{29}\) Carter was not willing to alienate the liberal wing entirely but tried to sit on the fence, which in due course lead to an inability to please either extreme within his Party.

The revolution in Iran and the subsequent hostage crisis caused further detriment not only to Carter’s foreign policy image, but also to his economic goals, since the decision to stop oil imports from Iran caused the price of oil to double in the U.S. during 1979-80 – having immediate and devastative inflationary consequences that heavily undermined Carter’s anti-inflation battle. Therefore Carter’s economic policy was significantly damaged by an external factor that the administration could not control even though it was attempted. In itself the inflation caused by this foreign policy decision is an indication that inflation was not only dependent on government expenses but also on other entirely unrelated matters. To what degree, however, remains debatable (in the 1980 ERP Carter states that inflation accelerated sharply “partly, but not solely” because of higher oil prices\(^ {30}\)).

Nonetheless, judging from figure 3 the inflation spike experienced in the United States in the late 1970s seems to have a solid correlation with energy prices. Therefore the inflation seems to have less to do with Keynesian economics but more with increasing world prices of oil that was further aggravated in the U.S. due to its high dependency on imported oil. Yet, in the eyes of the frustrated public, Carter had tried first to expand and then to contract the economy with exactly the same result – accelerating inflation. Additionally the Soviet invasion of Afghanistan, lead the administration to reallocate the diminished budget resources from social programs to military ones, since Carter did not want to seem weak in national defense, an objective utterly lost during the hostage crisis.


In the beginning of the final year of his presidency Carter singled inflation as the country’s primary economic woe and outlined a strategy for dealing with inflation. This strategy included four mutually complementarily approaches (of which the first was the most immediate according to Carter)\(^\text{31}\):

1) Fiscal and monetary restraint
2) Restraint by the private sector in its wage and price resolutions
3) Measures that improve productivity growth (supply-side economics)
4) Measures that reduce vulnerability to outside inflationary shocks

In introducing the first measure Carter hinted that forgoing tax reductions in future years would also be critical and should be coupled with budgetary restraint. In his last budget message Carter outlined future tax policy in the following terms:

Because it is the long-term policy of this administration to limit tax burdens, periodic tax reductions will carefully be considered between now and 1985. Such tax reductions will permit taxpayers to share the benefits of restraint. The appropriate timing, magnitude, and composition of tax cuts in the 1982–1985 period, however, depend upon future economic conditions and therefore must be determined at a later time.\(^\text{32}\)

---

\(^{31}\) Ibid, 4


(http://fraser.stlouisfed.org/publication/?pid=54), 6.
This uncertainty left Reagan fertile ground for his own economic strategy in the upcoming elections where he made tax reductions the central theme of his fiscal approach.

When analyzing the budget proposals of Carter and his administration it is intriguing to note the constant anomalies between estimated budget proposals and actual budget deficits. In his first budget, in January 1978, Carter was envisioning large deficits for the next three years which turned out to be much smaller than predicted – possibly because of the rediscovered austerity path. In contrast, the estimates made after the turn to restraint are regularly too optimistic about balancing the budget and underestimate the yearly deficits (this might also be an indication that austerity policy causes more short-term damage to the deficit than the Carter staff expected). Table 1 portrays this inaccuracy in predicting and controlling future budgetary matters. One can argue that the estimates only reflect the uncertainty in forecasting government finances, yet on the other hand one can witness a degree of political benevolence or misrepresentation in them since they rarely take into account how the budget will be altered in Congress even though this to some extent could be realistically estimated. The latter argument is especially forceful when one considers the fact that the administration’s closest budgetary estimate came in January 1981 when it was no longer in the running for a second term. This cannot be solely credited to the proximity of the estimate since it does not apply to the previous years.

Table 1. Estimated budget surplus or deficit in executive budget summaries versus actual (national currency, billions, not inflation adjusted).

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimates in 1978</td>
<td>-61,8</td>
<td>-60,6</td>
<td>-37,5</td>
<td>8,6</td>
</tr>
<tr>
<td>Estimates in 1979</td>
<td>*</td>
<td>-37,4</td>
<td>-29</td>
<td>-1,2</td>
</tr>
<tr>
<td>Estimates in 1980</td>
<td>*</td>
<td>*</td>
<td>-39,8</td>
<td>-15,8</td>
</tr>
<tr>
<td>Estimates in 1981</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>-55,2</td>
</tr>
<tr>
<td><strong>Actual Deficit</strong></td>
<td><strong>-48,8</strong></td>
<td><strong>-27,7</strong></td>
<td><strong>-59,6</strong></td>
<td><strong>-57,9</strong></td>
</tr>
</tbody>
</table>


The cuts in federal expenditure did not stop inflation but eventually did for one’s part cause an expected recession in 1980 by ceasing the growth of Real GNP that had occurred in the past few years despite increased prices. The unemployment rate – that
Carter initially had been able to reduce – was pushed back to 7.4 % in 1980, which caused bitterness within the Democratic liberals especially when the fiscal conservatism of the administration failed to curtail inflation.\textsuperscript{33} In retrospect, a considerable influence to the recession of 1980 was caused by the Federal Reserve’s tight monetary policy, which eventually succeeded in its anti-inflation objective, but kept the economy in a downtrend (regardless of administration) until the summer of 1982 when its chairman Paul Volcker opted for expansive monetary policy much to the delight of the Reagan administration.\textsuperscript{34} These economic conditions where stagflation was peaking, due to inconsistent economic policy and external factors, coupled with the fact that 52 Americans were still held hostage at Iran made Carter an easy target in the upcoming presidential elections, where Reagan would attack the incumbent president specifically on economics and national defense issues.

4.4. Joint Economic Committee Finds Unanimity in Supply-Side Policies

“Everybody is more conservative and more business-oriented”

– Senator Jacob B. Javits on the Joint Economic Committee in 1979\textsuperscript{35}

The traditional liberal Democratic stance of the Joint Economic Committee changed decidedly in the beginning of 1979 when Senator Lloyd M. Bentsen, a Democrat from Texas, became its chairman. Bentsen was known for his conservative economic policy views which soon formed a consensus within the committee. Remarkably the usual partisanship of the committee vanished under the guise of supply-side economics. In the 1979 annual report of the committee all the members of the committee endorsed the recommendations without major dissents and signed the document (Parren J. Mitchell hinted dissent, but still signed).\textsuperscript{36} In the report the committee recommended spurring

\textsuperscript{33} Campagna 1995, 445.

\textsuperscript{34} Krugman, Paul: Peddling Prosperity: Economic sense and nonsense in the age of diminished expectations. W.W. North, New York 1994, 118–121.


business investments with various means, for example, tax incentives and accounting alterations. The report does not advocate increasing public expenditure as opposed to the previous ones, but maintained the line of the Carter administration and accepted as reasonable the fact that the economy would slow down in the short-term and highlighted inflation as the economy’s top priority. Interestingly, however, the committee did part ways with the Carter administration in the remedies for reducing inflation. It advised against excessive budget-cutting (contrary to what Bentsen had recommended in 1978) and tight monetary policies, which would “barely make a dent in the inflation rate”. In a way the new JEC wanted out of stagflation without having to resort to painful fiscal policies and thus recommended further tax-cuts and more importantly incentives to the supply-side of the economy that would drag the economy back on track. The main deduction of the report was that stagflation was seen as the culprit of policies that have stimulated demand while neglecting supply. Bentsen himself remarked that the “report illustrates an emerging consensus in the committee and in the country that the federal government needs to put its financial house in order and that the major challenges today and for the foreseeable future are on the supply side of the economy”. This Bentsen-led JEC economic philosophy parted from Reaganomics only in the fact that it did not incorporate an equivalent aggressiveness for public sector downsizing as the latter did. Nonetheless, if inflation had to be combatted in other ways the JEC concluded that this should be done in the form cutting spending and not tighter monetary policy.

In the spring of 1979 the JEC held hearings related to a special study about the changing economic climate. The premise was that stagflation had made ineffective the traditional methods for achieving the objectives of the Employment Act of 1946. These hearings and the study in general offered a platform for the most distinguished economists of the time and, to a lesser extent, prominent business leaders, to express their views about stagflation and how to deal with it. Among the participants were inter alia Otto Eckstein, Philip Cagan, Wassily Leontief and Michael Wachter – professors of economic sciences from Harvard, Columbia, New York University and the University of Pennsylvania respectively. Of the various views presented at the hearings two major

standpoints emerge. The first one, mostly proclaimed by the professional economists, business leaders, and slightly by the academics was that stagflation was caused by excessive government involvement in the economy and that the possible short-run benefits of fiscal stimulation inevitably lead to massive inflation later on. Furthermore this position laid emphasis on encouraging investment which government involvement was supposedly crowding out of the market place. The argument was summarized by Beryl W. Sprinkel (at the time the Executive Vice President of Harris Trust & Savings Bank): “--- we can whip stagflation by if we are willing to change our present policy thrust. The costs will be high, but the benefits greater. Unless we are willing to change our profligate ways, inflation may threaten the very fabric of our democratic capitalistic system to the immense detriment of all our citizens.” On the other hand some of the economists seemed less willing to accuse the government engrossment as exclusively as others – even though Keynesian policies were largely ridiculed. Albert Sommers took part in this discussion by stating that:

I can’t characterize our behavior as improvement or grossly irresponsible. The Government’s share in this system has risen relatively modestly. It rises during cyclical recession. --- But measuring the share of Government against our full employment output --- it really has not risen dramatically. It has not risen faster than in other countries.

Overall the general consensus seemed to be that the unemployment issue of the late 1970s was a noncyclical one i.e. structural and therefore out of government control. More importantly the answer to this debate by the Committee’s vice chairman, Richard Bolling, reflects the common contemporary sentiment of the Committee: “Well, there are two contrary points of view flying around here. I keep hearing, and I think it is probably true, that the various increases in regulation of segments of the economy have added very substantial costs to the cost of doing business.”

From a Keynesian perspective it is intriguing to observe that the Committee’s focus on the supply-side of the economy – that is adding productivity growth by tax cuts, 

---


41 Ibid, Public Panel Discussion on Stagflation.
accounting reforms, effective management and other incentive inducing processes – was seen as a zero-sum game in relation to government demand policies. In this the Committee went along with the economists who doubted that government cannot possibly foresee the general direction of the economy and could not itself invest in a way that would combine the short-run problem with the long-run. Under this assumption publically targeted working programs, for example, only train the unemployed to do something where there are no employment opportunities later on. Consequently this leads to the conclusion that government in general should only enable incentives that the private sector can subsequently utilize and rules out the possibility that the public economy can simultaneously do both options. The underlying principle behind this chain of thought is that market forces invest more efficiently at any given time. This forms the bridge between neoclassical and supply-side thinking the difference being that the latter – displaying a hint of theoretical contradiction – thought that it could determine the most efficient ways to increase economic incentives. It is important to note that supply-side economists wanted tax cuts for complete different reasons than Keynesian economists; the former advocated it to promote business incentives while the latter thought it as an indirect way to increase total demand for goods and services by leaving more disposable income in the hands of households. In any way there is a paradox in the fact that the various economists (e.g. Otto Eckstein: “The place to begin is to bring aggregate demand down to a level that the economy can sustain”) wanted primarily to decompress demand even though they in tandem commended tax cuts that, albeit indirectly, spurs demand.

In the annual report of 1980 the Joint Economic Committee made a strong recommendation towards a future tax cut. While maintaining that cutting back Federal expenditure was mainly a good thing the report also argued that the restraint by the Carter administration would ultimately stifle the economy if not coupled with tax cuts. In the report Bentsen stated that Americans would not have to suffer from increased unemployment to overcome inflation if the JEC’s recommendations for productivity gains would be implemented. These productivity gains are widely seen as tax cuts that favor the business sector, since they act not only as countercyclical devices as traditionally viewed but also effectively reconstruct the economy at large. Interestingly

---

the basis of this view was founded upon the work of Dr. Otto Eckstein and Data Resources Inc. (which Eckstein had co-founded\textsuperscript{43}) which is presented in the report. The consulting company was hired by the JEC in order to introduce an economic model by which policymakers could implement the supply side philosophy that the committee was advocating. In the report Data Resources, for example, argue that every $10 billion reduction in business taxes through depreciation allowances could bring inflation down by one percentage point without changing the unemployment rate.\textsuperscript{44} Nonetheless, increased productivity was the main reason for a future tax cut. All in all the report gave 32 policy recommendations for the future but in short the JEC’s economic policy guidelines can be summarized as a threefold approach: 1) a $25 billion tax cut that would boost business capital incentives and consequently productivity, 2) tight monetary policy and 3) fiscal restraint by the Federal Government as proposed by Carter. The policy mix in itself cannot be considered as exceptional since apart from tight monetary policy it resembled Ford’s economic policy in 1975–76. Yet the fact that it was supported by a Democratic majority (in a downtrend) and unlike before backed by scientific economic analysis which made the reasoning for the tax cut solely on supply side grounds emphasizes the paradigm shift away from Keynesianism.

One year after presenting a unified front the JEC, of 20 members, had some dissenting voices in the 1980 report. These came from two Democrats, Senator William Proxmire and Representative Parren Mitchell, for markedly different reasons. Proxmire – exhibiting the new-found fiscal conservatism within the Democratic Party – thought along the lines of the Carter administration that a tax cut must be earned by slashing more from Federal expenditure and balancing the budget first whereas Mitchell believed that possible tax cuts should be coupled with programs aiming high unemployment areas.\textsuperscript{45} The fact that Mitchell was dissenting the committee’s recommendations is especially interesting since he was the only dark-skinned member of the committee and the supply-side policies advocated by the majority were founded upon the argument that they would be particularly helpful for the black minorities. Mitchell wanted to curtail

\textsuperscript{43} Later on the company went on to become the largest non-governmental distributor of economic data.


inflation by monetary policy and did not see restraint in fiscal policy as crucial in achieving this objective. As figure 3 demonstrates, minority unemployment in the United States was structural to a degree that mere economic policy despite its divergent intentions could not resolve.

Figure 5. United States Unemployment Rates According to Race (seasonally adjusted)


The radical swerve of the JEC in 1979 to supply-side policies is further proof that Keynesian policymaking had lost control of an increasingly larger part of the Democratic Party. Remarkably this shift in thinking came despite the fact that the composition of the committee remained largely the same from the 95th to the 96th Congress (see appendix 1). While many liberals still expressed dissatisfaction they were progressively outnumbered and being pushed out of the politico-economic limelight. It is notable that this loss of influence happened within the span of a few years starting from the modifications made to the Humphrey-Hawkins bill and ironically even more noticeably after the bill had become law. Clearly the anti-inflation argument became significantly stronger after the 1979 oil crisis. The last ray of hope of the liberal wing died out as Carter secured the Democratic presidential nomination for 1980.
4.5. The Role of Economics in the 1980 elections

What is important to recognize in regard to Carter is that he was fundamentally challenged by his own party in the presidential nomination preceding the 1980 elections. Due to Carter’s departure from the traditional Democratic economic objectives, disillusioned liberals within the party found a formidable candidate when Senator Edward M. Kennedy decided to pursue the nomination. During Carter’s term Kennedy had publically criticized the administration’s economic policy on a number of occasions as a member of the JEC before Bentsen became its chairman after which Kennedy interestingly voiced little discontent – a possible explanation might be that he seldom attended the committee’s hearings. Nonetheless, Kennedy saw an opening in the left flank of Carter’s political standing, especially when it came to economic matters. Furthermore, in 1979, polls showed that Kennedy was actually a two-to-one favorite over President Carter among Democratic voters. The difficulty Carter faced in this initial stage illustrates the fact that the economy would become a crucial stumbling block that was attacked initially from the left, and later successfully from the right of the political spectrum. After a long struggle that caused serious friction within the Democratic Party the Kennedy campaign ended up falling short on deposing the incumbent president, not because of lack of support on the economic issues, but more due to the perceived character flaws of Senator Kennedy (especially the notorious incident on Chappaquiddick Island in 1969). Nevertheless, in conceding his loss Kennedy offered a New Deal-style speech in which he articulated the economic case against Carter:

The demand of our people in 1980 is not for smaller government or bigger government but for better government. Some say that government is always bad and that spending for basic social programs is the root of our economic evils. But we reply: The present inflation and recession cost our economy $200 billion a year. We reply: Inflation and unemployment are the biggest spenders of all.47

The pro-Keynesian economic aspect went down with Kennedy and what was left in the general elections was a rather conservative economic view by the Democrats against a radical neo-conservative one presented vividly by Ronald Reagan. Although Carter was not advocating on economic policy based Keynesianism his opponent’s views were still

46 Haas, 116-117
47 Ibid., 118.
mainly aimed against it, which also meant that Reagan had to emphasize the destructive force of government intervention and taxation even though Carter had initiated deregulatory programs and cut taxes on multiple occasions.

Reagan’s economic policy was also questioned within the Republican Party – most significantly by George H. Bush who called it “voodoo economics”.\textsuperscript{48} Ironically, Bush became the vice-presidential candidate in Reagan’s ticket later on Reagan’s policy objective of the pursuit to restructure the economy according to the free market was not particularly controversial, and neither was the accusation that the Federal government had distorted the economy. The reason why Bush had accused Reagan’s economic ideology of basing its beliefs on voodoo was because of the determinedly advocated idea that sharp tax cuts would make everything else subside. In other words the remarkable growth stimulated by large tax cuts and deregulation would generate enough revenue to close out the government deficit, increase employment (by encouraging companies to invest) but still keep inflation in check. Reagan took the Republican Party to uncharted waters with this economic policy idea that did not need to worry about offsetting the tax cuts by reducing expenditure – as Ford had done – simply because the former would be so significant.

Even though the supply-side economics that Reagan endorsed were also based on academic studies (e.g. negative effect taxation had on incentives, rational expectations) this particular policy was stretching the scrutinized analysis into a simple yet radical solution in placing the fault of the economy solely on the hands of the punitive tax system. The approach was a lot cruder than the original supply-side argument and economists, who did not uniformly pledge to the supply-side diagnosis in the first place, scoffed at its prescription modified by the Reagan campaign. However, it was one that the mainstream economists tentatively leaning towards Keynesianism had a hard time refuting at the time, since economic history did not provide a telling cautionary tale nor were the public willing to hear complicated interpretations from people who for the past decade had been so aghast in explaining and solving stagflation. Reagan was finally offering a simple solution to the economic crisis which hit a chord with the frustrated electorate that had only heard promises of continued austerity and fiscal responsibility (with the brief exception of the Carter presidential campaign in the fall of 1976) since

\textsuperscript{48} Ibid., 144-150.
the ascendency of Ford. In the economic field Reagan tried and succeeded in shedding the austerity image that the Republicans had drawn to public perception in the past. Instead he adopted a simplified version of the supply-side argument and coupled it with a strong dose of government mistrust. Carter, on the other hand, had shaped himself into being exactly the opposite: the torchbearer of austerity policies – partly due to past political necessity and partly because of his own economic mindset – with few practical short-term solutions. In a way the incumbent had inherited Ford’s economic campaign of four years earlier and it proved to be just as unpopular with electorate as before.

“Are you better off than you were four years ago?” was the question asked repeatedly by Reagan of the American voters during the 1980 presidential campaign. The fact that the unemployment rate had become considerably worse during the spring and summer of 1980 and resembled the rates of 1976 (see table in appendix 3) while inflation was much more out of control than before made the question’s innuendo quite unequivocal. In a televised national debate Carter focused on arms control and energy policy, which he warned (correctly as it turned out) would get neglected if Reagan became president. Nevertheless, these were at the time speculative issues whereas Reagan’s criticism of the current administration’s bad economic record was substantive and much more difficult to defend. While Carter objected that the proposed large tax cuts by Reagan were “completely irresponsible” he could not offer a valid economic alternative since he had committed himself completely to the dogma of austerity.

Reagan’s “Economics of Joy”, as economist Anthony S. Campagna labels it, coupled with an increased emphasis on national defense issues gained wide acceptance, but it remains debatable how much the economic policies of the presidential candidates actually differed from each other in the 1980 general elections, and what made the constituency ultimately vote for Reagan. While it is safe to conclude that Reagan’s supply-side philosophy was radical in its attitude towards taxes and deficits – especially when compared with previous Republicans on the latter – it also important to observe that Carter’s economic proposals were not significantly dissimilar when it came to taxes. For example, Carter was proposing tax cuts of $27 billion in 1981 while Reagan had $31.9 in mind. This illustrates the fact that the 1980 elections were essentially not


Keynesian policies vs. supply-side economics, which made Reagan’s attack against big government that much more effective, since the opponent was not willing to defend it.

Days before the elections economist and Nobel laureate Lawrence R. Klein reported publicly that there was no measurable difference in the impact of the two candidates’ economic positions in the short-term.\textsuperscript{51} The fact that both parties had candidates that more or less denied Keynesian economics highlights the downfall that the theory had experienced during the 1970s. Nevertheless, the economy played a decisive role in the outcome of the 1980 elections – a survey done after the elections indicated that 73\% of the electorate considered the economy the nation’s greatest concern\textsuperscript{52} – since Reagan was offering something radically new while Carter was offering something already tried and failed upon. Yet, contrary to the general narrative of late 20\textsuperscript{th} century economic history in this case the policy that Carter had failed with was not Keynesian economics even though some (or even the majority) of the voters probably thought so, but austerity policies stressing expenditure restraint with tax cuts. Every year of the Carter administration had seen a budget deficit but compared with the ones that his successor would accumulate they were rather conservative as seen in figure 5 and, with the possible exception of 1980, do not represent a significant stimulus in the Keynesian sense.

\textsuperscript{51} Rattners, Steven: The Economy on the Ballot. \textit{The New York Times} 2\textsuperscript{nd} November 1980.

\textsuperscript{52} Clymer, Adam: Polls show Iran and the Economy hurt the Carter among late-shifting voters. \textit{The New York Times} Nov 16\textsuperscript{th} 1980.
Figure 6. The revenue and expenditure of the United States Federal Government 1970–1985 (national currency, current prices, millions).

Source: OECD statistics/ user-generated (http://stats.oecd.org/)
Conclusions

“The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.”¹ – John Maynard Keynes

Ironically, the U.S. federal deficit of which the Republicans and conservative Democrats had been concerned about during the presidency of Ford and especially vocal during the Carter years exploded under the management of “Reaganomics” – the ratio of federal debt to GDP (size of debt compared to size of economy) accelerated remarkably after Regan’s ascendency to power.² Reagan was unable to cut federal expenditure to a degree he had promised and ended up merely re-allocating federal money from social programs to military expenditure while simultaneously reducing the government’s proportional share on corporate taxes and significantly increased the aggregate amount of federal expenditure and borrowing (see figure 5 and table 2). Furthermore, the steep tax cuts did not have the effects on the economy that the supply-side economists and Reagan had convinced the public and employment took a deep plunge in 1981-82 as the economy went into a severe recession (see table 3 in appendix 3). In the climaxed struggle between simultaneous unemployment and inflation the Reagan administration in conjunction with the Federal Reserve decidedly opted to defeat the latter at the expense of the former. Furthermore, the country became satisfied with the fact that the unemployment rate would not reach the levels that were customary during the Golden Age.³

Nonetheless, it was partly due to this momentary, deep recession that inflation was eventually curtailed and without much fanfare disappeared from the political limelight.

¹ Keynes 1936, 241.
Apart from being viewed as the administration’s greatest economic achievement, diminished inflation in the 1980s lends strong support to Kennedy’s proclamation in 1962 that the automated relation between deficits and inflation is to some extent a myth, since in this case massive deficits and federal expenditure did not bring with it surging prices but actually played a small role in turning the economic tide in the opposite direction. The fact that the foregoing is deeply inconsistent with the view that Keynesianism failed in the 1970s because its excessive spending generated a highly inflationary environment remains something of a blind spot.

Table 2. Comparison between United States Federal Government Receipts and Expenditure (proportional share of total) in 1979 and 1986

<table>
<thead>
<tr>
<th>Expenditure</th>
<th>1979</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Direct payment to individuals</td>
<td>37</td>
<td>41</td>
</tr>
<tr>
<td>National Defense</td>
<td>24</td>
<td>29</td>
</tr>
<tr>
<td>Net Interest</td>
<td>8</td>
<td>15</td>
</tr>
<tr>
<td>Other Federal Operations</td>
<td>14</td>
<td>5</td>
</tr>
<tr>
<td>Grants to States and Localities</td>
<td>17</td>
<td>10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Receipts</th>
<th>1979</th>
<th>1986</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excise Taxes and other</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>Borrowing</td>
<td>12</td>
<td>18</td>
</tr>
<tr>
<td>Individual Income Taxes</td>
<td>38</td>
<td>37</td>
</tr>
<tr>
<td>Social Insurance Receipts</td>
<td>28</td>
<td>30</td>
</tr>
<tr>
<td>Corporation Income Taxes</td>
<td>13</td>
<td>8</td>
</tr>
</tbody>
</table>


Therefore when this detailed presentation of U.S. economic policy during the period of stagflation is juxtaposed with the wider historiographical legacy of Keynesianism in the 1970s a clear rift can be observed. Stagflation could not emerge as a cause of zealous Keynesian policymaking per se since the policy itself was to large degree neglected or clearly distorted within the governing body. The Johnson and Nixon administrations overheated the economy for their own political purposes with a complete disregard to the economic circumstances to which Keynes had designed the policy solution. These experiences caused significant damage to the image of Keynesianism and therefore Ford’s reaction to the recessions of his presidency, hardly representing a Keynesian
response, can be better understood. Ford faced an economic situation unknown to the modern economy and offered initially a balanced budget as the solution, but ended up performing an understandable policy compromise and ultimately postponed the problem to his successor. Carter, on the other hand, was simply not the emblem of Keynesianism that his political background might ostensibly suggest and apart from the original economic program of 1977 did not apply Keynesian fiscal policy in practice despite the fact that some members of the Democratic Party demanded it. Carter and his CEA threw the Keynesian deficit-spending policy option out of the door before implementation and undermined it continuously in rhetoric and practice. The reluctance to implement deficits-spending when necessary, and to willingly hurl oneself into it when unnecessary, gaudily illustrates Joan Robinson’s claim that Keynesianism was bastardized in the United States.

Going back to North’s theory on economic change (perceived reality → beliefs → institutions → policy → altered perception of reality) presented in the opening chapter of this thesis it seems evident that the Ford administration did not have a belief in Keynesian policymaking due to a perception that increased federal expenditure in an economic downturn would merely aggravate inflation and generally be irresponsible and ineffective. Sequential policy did not reflect this thinking purely, however, since Democrats still had confidence in the theory in 1974–76 and the liberal wing kept that trust in place until the implementation of government enhanced employment opportunities, such as the Humphrey-Hawkins Act, became impossible to enact on a large-scale. As Carter’s conservative economic policy and even more lucidly the JEC’s turnaround in the late 1970s demonstrates, economic reasoning between the left and the right came to resemble each other much more than before by the end of the decade and the new-old perception that the market could not be controlled through government programs prevailed. The notion that government should equip the economy with the best possible surroundings by enhancing its supply-side factors was not intrinsically incompatible with Keynesianism’s basic conclusion of government acting in a countercyclical manner. However the fact that supply-side economics was based on the assumption that this was counter effective, and gained recognition by emphasizing it, made the fit conceptually unfeasible.

On the basis of this foregoing interpretation – and the dissertation in general – a broad arch of Keynesianism in the United States can be categorized into three phases between
1930 and 1980. First of all, a number of historical events (mainly the Great Depression and the Second World War) combined with the inception of Keynesianism led to a substantive increase in governmental control over the economy and enjoyed reasonable success for an extended period of time. In the second phase, government control malpractices the theory in the late 1960s and early 1970s and with the assistance of external events, most significantly the OPEC oil crisis, brings about an economic condition where increasing inflation and unemployment overlap. Finally as a solution to the novel situation Keynesianism is disregarded already during the mid-1970s and progressively until the 1980 elections since it is perceived as the culprit of the issue at hand and with the help of a new spike in oil prices in the late 1970s stagflation reaches its high point in the U.S. giving further credence to the failure of the theory.

Thus through North’s conceptual system this study has observed that the initial perceived reality, in the beginning of the first oil crisis, was severely skeptic of Keynesianism and due to a mismatch between beliefs the economic policy that followed consisted largely of agreement on tax cuts and disagreement upon the extent of budgetary expenditure. Gradually the notion that government involvement in the economy should be made as minimal as possible became more acceptable and the political establishment in the United States embraced it by 1980. The new-found belief system – also known as the Washington consensus – combined supply-side economics with neoclassical and monetarist theory and, by making monetary policy the main economic policy measure, left activist fiscal policy to the sidelines. It is worth stressing, however, that the basic thrust and assumptions of the theories that replaced Keynesianism, even though mathematically much more sophisticated, were compatible with classical economic thinking (hence neoclassical). Consequently the power of these underlying ideas had never disappeared but played a conflicting influence on the interpretation and implementation of Keynesianism as the struggles in implementing it during the 1970s illustrates. The simple basic ideas of it (see quotation from page 16) had not become acceptable or understood in American politics and therefore the confused economic policy of the 1970s can be seen as a reflection of this lack of faith.

The example of the United States therefore stands in opposition to the narrative that Keynesianism failed through trial and error in the 1970s and demonstrates that the theory itself did not enjoy the type of dominance over classical economic thinking that historical presentations often depict. Perhaps it is not a clear-cut failure that plunges a
theory, but a combination of political circumstances and new theories; as Schumpeter said: “It takes a theory to kill a theory.” In this case monetarism, supply-side arguments and the neoclassical school, including the “Rational Expectationists” led by Robert Lucas, in conjunction with the political – conscious or unconscious – misapprehension of Keynesianism led to the paradigm shift in economic thinking.

Economists and economic historians tend to disregard the economic policy of administrations during stagflation on one of two grounds that usually reflect the political tendencies of the scholar in question: either the economic policies were nullified by external events or they contributed in aggravating inflation. These interpretations reflect the complex matrix that hinders the comprehensive understanding and deductions made from the economic policies of the 1970s; there are multiple variables – that rest upon international and domestic factors – intertwined, in addition to the profound political beliefs at stake. It is the conclusion of this study and its author that the question should not be placed solely on whether economic policies during stagflation were successful or not, but also to the more fundamental problem of what they actually represent. For example, convicting Keynesian economics about breaking down in the 1970s should incorporate valid empirical knowledge that they were actually practiced during that period, and how properly this was done. Only after a careful analysis of the policy and concepts in question can one determine whether it failed or was simply tossed aside.

In other words, linking economic policies to their political context provides a number of critical insights that are of assistance when forming notions about proximate causes. Forthcoming historical research about the economic policies during stagflation could concentrate on a more comprehensive and comparative historiographical analysis that extends the questions posed in this study by comparing the United States with similar countries in Western Europe during the same time period or exploring them separately. Additionally future research should evaluate the power of political rhetoric when it comes to national budget deficits and investigate the correlation between inflation and deficits through historical illustrations.

---

The conclusions presented here ultimately reinvigorate a perspective paradigm regarding the issue. They result simply upon a demand to increase and incorporate the study of human agency and, more importantly, empirical policy analysis in explaining the fall of Keynesianism. By complementing the actions of individuals with the structural reasons presented in page 6 and 7, future studies will be able to better explain the fate of Keynesian theory in general. Furthermore, by examining and comparing the structural with the individualistic and their possible antinomy, which this thesis has brought to light, researchers may indeed discover a new proper narrative which explains the outcome of Keynesianism differently than what the current orthodox description suggests.

After monetarism had gained an influential role in government and was experimented most aggressively by the Reagan administration and Mrs. Thatcher’s in Great Britain in the late 1970s and early 1980s the results varied from mixed to terrible depending upon the evaluator. Milton Friedman on his part admitted that the policy had failed but asserted that he fault was not in his theory per se, but more on the central bank authorities that were unable to execute his thoughts in practice.5 Through the looking glass, would it have been reasonable for Keynes (and his followers) to have used the same train of thought in regard to the theory’s downfall in the 1970s?

When Friedrich von Hayek wrote about being an economist he referred to Keynes and specifically to his quotation about the power of economic ideas presented in the beginning of this chapter. To it he only wanted to add one afterthought: “--- economists only have this great influence in the long run and only indirectly, and that when their ideas begin to have effect, they have usually changed their form to such an extent that their fathers can scarcely recognize them.”6

---


Bibliography

Published Primary Material

Reports


Hearings


Web Material

Documents available through the Federal Reserve Archival system for Economic Research (FRASER) http://fraser.stlouisfed.org/

Economic Report of the President


**Budget of the United States Government**


**Speech**

(http://millercenter.org/scripps/archive/speeches/detail/3283)
Published Secondary Material

Newspaper articles:

**The Washington Post**


**The Wall Street Journal**


**The New York Times**


**Literature:**


**Scientific Journals:**


Web material:


OECD statistics (http://stats.oecd.org/).

U.S. Bureau of Economic Analysis (http://www.bea.gov/).
Appendix 1. Composition of Joint Economic Committee’s, 93rd – 96th Congress.

93rd Congress:

Chairman: Wright Patman, Democrat
Vice Chairman: William Proxmire, Democrat

House of Representatives:                  Senate:

Richard Bolling, Democrat                  John Sparkman, Democrat
Henry S. Reuss, Democrat                    J.W. Fulbright, Democrat
Martha W. Griffiths, Democrat              Abraham Ribicoff, Democrat
William S. Moorhead, Democrat              Hubert H. Humphrey, Democrat
Hugh L. Carey, Democrat                    Lloyd M. Bentsen, Democrat
William B. Widnall, Republican              Jacob J. Javits, Republican
Barber B. Conable, Republican              Charles H. Percy, Republican
Clarence J. Brown, Republican               James B. Pearson, Republican
Ben B. Blackburn, Republican                Richard S. Schweiker, Republican

94th Congress:

Chairman: Hubert H. Humphrey, Democrat
Vice Chairman: Wright Patman, Democrat

House of Representatives:                  Senate

Richard Bolling, Democrat                  John Sparkman, Democrat
Henry S. Reuss, Democrat                    William Proxmire, Democrat
William S. Moorehead, Democrat              Abraham Ribicoff, Democrat
Lee H. Hamilton, Democrat                   Lloyd M. Bentsen, Democrat
Gillis W. Long, Democrat                    Edward M. Kennedy, Democrat
Clarence J. Brown, Republican  Jacob K. Javits, Republican
Garry Brown, Republican  Charles H. Percy, Republican
Margaret M. Heckler, Republican  Robert Taft Jr., Republican
John H. Rousselout, Republican  Paul J. Fannin, Republican

95th Congress:
Chairman: Richard Bolling, Democrat
Vice Chairman: Hubert H. Humphrey (died in 1978 and replaced by Bentsen)

House of Representatives:  Senate:

Henry S. Reuss, Democrat  John Sparkman, Democrat
William S. Moorhead, Democrat  William Proxmire, Democrat
Lee H. Hamilton, Democrat  Abraham Ribicoff, Democrat
Gillis W. Long, Democrat  Lloyd M. Bentsen, Democrat
Otis G. Pike, Democrat  Edward M. Kennedy, Democrat
Clarence J. Brown, Republican  Jacob K. Javits, Republican
Garry Brown, Republican  William V. Roth, Republican
Margaret M. Heckler, Republican  James A. McClure, Republican
John H. Rousselout, Republican  Orrin G. Hatch, Republican
Parren J. Mitchell, Democrat (after Humphrey’s departure)
96th Congress:

Chairman: Lloyd M. Bentsen, Democrat
Vice Chairman: Richard Bolling, Democrat

House of Representatives: Senate:

Henry S. Reuss, Democrat William Proxmire, Democrat
William S. Moorehead, Democrat Abraham Ribicoff, Democrat
Lee H. Hamilton, Democrat Edward M. Kennedy, Democrat
Gillis W. Long, Democrat George McGovern, Democrat
Parren J. Mitchell, Democrat Paul S. Sarbanes, Democrat
Clarence J. Brown, Republican Jacob K. Javits, Republican
Margaret M. Heckler, Republican William V. Roth, Republican
John H. Rousselout, Republican James A. McClure, Republican
Chalmers P. Wylie, Republican Roger W. Jepsen, Republican
Appendix 2. Excerpt from Joint Economic Committee Hearing October 28th 1975

Greenspan: ---I am a little puzzled by the thought that the particular sequence of events proposed was selected largely because of political considerations. And I must say that, having been part of the discussions, I know this was not the basis for the decision. I find the idea that it would be politically desirable to curtail politically popular expenditure programs several weeks before an election to be odd. The tax cuts are way in advance of election while the spending cuts come just before it. I do not know what that means politically---

Chairman Humphrey: No, no, let me just help you. You surely are not a politician.

Representative Long: You really are not.

Chairman Humphrey: Don’t run for office.

Greenspan: I am always glad to be instructed by a professional.

Chairman Humphrey: You see, there is a momentum in trends. And thus you can stimulate the economy with those tax cuts, with this excessive deficit spending. And I charge the administration with reckless deficit spending in the first few months of 1976, exactly as it did in 1972. In 1972, Mr. Greenspan, you take a look and see what happened. They opened the floodgates at the Treasury. They opened up the floodgates of the impounded funds and let them flush out like a tidal wave, and Mr. Burns apparently could not get his hand on the shutoff valve on the money supply until around July.

Greenspan: I am always delighted to be instructed by you, Mr. Chairman.

Chairman Humphrey: Let me, then give you lesson, the economics of politics or the politics of economics is trend. When you get that sudden injection that you are
putting into the economy in copious quantities of $28 billion, you give it a real stimulus.

Greenspan: Let me first say that one, with respect to 1972, I was not here then.

Humphrey: But I was around.
Appendix 3. Additional Figures and Statistical Tables

Figure 7. United States current account balance as a percentage of GDP 1970–1995

![Graph showing United States current account balance as a percentage of GDP 1970–1995.](image)

Source: OECD statistics/user-generated (http://stats.oecd.org/)

Table 3. United States monthly labour force unemployment rate 1970–1987

<table>
<thead>
<tr>
<th>Year</th>
<th>Jan</th>
<th>Feb</th>
<th>Mar</th>
<th>Apr</th>
<th>May</th>
<th>Jun</th>
<th>Jul</th>
<th>Aug</th>
<th>Sep</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>3.9</td>
<td>4.2</td>
<td>4.4</td>
<td>4.6</td>
<td>4.8</td>
<td>4.9</td>
<td>5.0</td>
<td>5.1</td>
<td>5.4</td>
<td>5.5</td>
<td>5.9</td>
<td>6.1</td>
</tr>
<tr>
<td>1971</td>
<td>5.9</td>
<td>5.9</td>
<td>6.0</td>
<td>5.9</td>
<td>5.9</td>
<td>5.9</td>
<td>6.0</td>
<td>6.1</td>
<td>6.0</td>
<td>5.8</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td>1972</td>
<td>5.8</td>
<td>5.7</td>
<td>5.8</td>
<td>5.7</td>
<td>5.7</td>
<td>5.6</td>
<td>5.6</td>
<td>5.5</td>
<td>5.6</td>
<td>5.3</td>
<td>5.2</td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>4.9</td>
<td>5.0</td>
<td>4.9</td>
<td>5.0</td>
<td>4.9</td>
<td>4.9</td>
<td>4.8</td>
<td>4.8</td>
<td>4.8</td>
<td>4.6</td>
<td>4.8</td>
<td>4.9</td>
</tr>
<tr>
<td>1974</td>
<td>5.1</td>
<td>5.2</td>
<td>5.1</td>
<td>5.1</td>
<td>5.1</td>
<td>5.4</td>
<td>5.5</td>
<td>5.5</td>
<td>5.9</td>
<td>6.0</td>
<td>6.6</td>
<td>7.2</td>
</tr>
<tr>
<td>1975</td>
<td>8.1</td>
<td>8.1</td>
<td>8.6</td>
<td>8.8</td>
<td>9.0</td>
<td>8.8</td>
<td>8.6</td>
<td>8.4</td>
<td>8.4</td>
<td>8.3</td>
<td>8.3</td>
<td>8.2</td>
</tr>
<tr>
<td>1976</td>
<td>7.9</td>
<td>7.7</td>
<td>7.6</td>
<td>7.7</td>
<td>7.4</td>
<td>7.6</td>
<td>7.8</td>
<td>7.8</td>
<td>7.6</td>
<td>7.7</td>
<td>7.8</td>
<td></td>
</tr>
<tr>
<td>1977</td>
<td>7.5</td>
<td>7.6</td>
<td>7.4</td>
<td>7.2</td>
<td>7.0</td>
<td>7.2</td>
<td>6.9</td>
<td>7.0</td>
<td>6.8</td>
<td>6.8</td>
<td>6.8</td>
<td>6.4</td>
</tr>
<tr>
<td>1978</td>
<td>6.4</td>
<td>6.3</td>
<td>6.3</td>
<td>6.1</td>
<td>6.0</td>
<td>5.9</td>
<td>6.2</td>
<td>5.9</td>
<td>6.0</td>
<td>5.8</td>
<td>5.9</td>
<td>6.0</td>
</tr>
<tr>
<td>1979</td>
<td>5.9</td>
<td>5.9</td>
<td>5.8</td>
<td>5.8</td>
<td>5.6</td>
<td>5.7</td>
<td>5.7</td>
<td>6.0</td>
<td>5.9</td>
<td>6.0</td>
<td>5.9</td>
<td>6.0</td>
</tr>
<tr>
<td>1980</td>
<td>6.3</td>
<td>6.3</td>
<td>6.3</td>
<td>6.9</td>
<td>7.5</td>
<td>7.6</td>
<td>7.8</td>
<td>7.7</td>
<td>7.5</td>
<td>7.5</td>
<td>7.5</td>
<td>7.2</td>
</tr>
<tr>
<td>1981</td>
<td>7.5</td>
<td>7.4</td>
<td>7.4</td>
<td>7.2</td>
<td>7.5</td>
<td>7.5</td>
<td>7.2</td>
<td>7.4</td>
<td>7.6</td>
<td>7.9</td>
<td>8.3</td>
<td>8.5</td>
</tr>
<tr>
<td>1982</td>
<td>8.6</td>
<td>8.9</td>
<td>9.0</td>
<td>9.3</td>
<td>9.4</td>
<td>9.6</td>
<td>9.8</td>
<td>9.8</td>
<td>10.1</td>
<td>10.4</td>
<td>10.8</td>
<td>10.8</td>
</tr>
<tr>
<td>1983</td>
<td>10.4</td>
<td>10.4</td>
<td>10.3</td>
<td>10.2</td>
<td>10.1</td>
<td>10.1</td>
<td>9.4</td>
<td>9.5</td>
<td>9.2</td>
<td>8.8</td>
<td>8.5</td>
<td>8.3</td>
</tr>
<tr>
<td>1984</td>
<td>8.0</td>
<td>7.8</td>
<td>7.8</td>
<td>7.7</td>
<td>7.4</td>
<td>7.2</td>
<td>7.5</td>
<td>7.5</td>
<td>7.3</td>
<td>7.4</td>
<td>7.2</td>
<td>7.3</td>
</tr>
<tr>
<td>1985</td>
<td>7.3</td>
<td>7.2</td>
<td>7.2</td>
<td>7.3</td>
<td>7.2</td>
<td>7.4</td>
<td>7.4</td>
<td>7.1</td>
<td>7.1</td>
<td>7.1</td>
<td>7.0</td>
<td>7.0</td>
</tr>
<tr>
<td>1986</td>
<td>6.7</td>
<td>7.2</td>
<td>7.2</td>
<td>7.1</td>
<td>7.2</td>
<td>7.2</td>
<td>7.0</td>
<td>6.9</td>
<td>7.0</td>
<td>7.0</td>
<td>6.9</td>
<td>6.6</td>
</tr>
<tr>
<td>1987</td>
<td>6.6</td>
<td>6.6</td>
<td>6.6</td>
<td>6.3</td>
<td>6.3</td>
<td>6.2</td>
<td>6.1</td>
<td>6.0</td>
<td>5.9</td>
<td>6.0</td>
<td>5.8</td>
<td>5.7</td>
</tr>
</tbody>
</table>

Figure 8. Percent Change From Preceding Period in Real Gross Domestic Product 1950–1993

Source: U.S. Bureau of Economic Analysis (http://www.bea.gov/).