THE COUNCIL OF ECONOMIC ADVISERS:
CONSCIENCE OR ADVOCATE?

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The Council of Economic Advisers (CEA) stands as a unique institution in political life. While political leaders need and value informed advice on most matters, in the United States Presidents are given a ready-made institution from which to obtain economic intelligence. Since the Employment Act of 1946, Presidents have been saddled with an agency which is the official, and generally the informal, channel through which economic advice is obtained. What are the CEA's responsibilities? What conflicts does it face? How well has it performed its tasks? I will address these issues.

A. RESPONSIBILITIES OF THE CEA

Statutory Duties

What are the CEA's responsibilities? The statutory obligations were laid out in the 1946 Employment Act and amended in the Full Employment Act of 1978. Under the 1946 Act, the duties and functions of the Council are:

1. to assist the President in the preparation of the (President's) economic report;
2. to analyze economic trends and Federal economic policies and to submit such analyses to the President; and
3. to develop and submit to the President recommendations for economic policies designed "to foster and promote free competitive enterprise, to avoid economic fluctuations or to diminish the effects thereof, and to maintain employment, production, and purchasing power."

The Council has no line responsibilities; rather, its efforts are primarily designed to inform and assist the President.

The 1978 Full Employment Act (P.L. 95-523) adds and subtracts nothing of substance. It merely authorizes and directs the Council to "seek and obtain the cooperation" of other governmental bodies in carrying out its
functions.

**Actual Duties**

What are the tasks in reality? They are myriad; moreover, they will differ from Council to Council depending on the way the ideological winds are blowing, as well as on the power of the Council. Surprisingly, the tasks are remarkably constant over time.

1. **Give Economic Advice to the White House.** The CEA has an audience of one—the President. The Council chairman generally tries to educate the President on the key economic issues of the day. In some administrations, these sessions were enormously influential, leading to the introduction of activist fiscal policies and the war on poverty during the Kennedy-Johnson years. At other times, the President turned a deaf ear to the CEA, as during the later days of the Feldstein chairmanship. The power of the Council ultimately rests on its ability to persuade the President of the soundness of its views.

2. **Write the Economic Report of the President and the Council of Economic Advisers.** Once a year, the CEA surfaces in public with its report (which actually follows the short and unread President's report). Writing the Economic Report takes a prodigious amount of time of the staff and members, and the product is surely valuable as a statement of the economic philosophy of the administration. Occasionally the Report is so innovative that it is at the frontier of economic research, as in the legendary 1962 Report. Note that the Report is written at a critical time of year, when budget and fiscal policy decisions are taken. I have sometimes thought that the report was a Machiavellian requirement devised by competing interests in the executive branch to distract the CEA from participating in the more important activities of determining policy rather than explaining it.

3. **Public Advocacy.** Council members often testify before Congress, give public speeches, write articles, and defend or explain the administration's economic policies.

4. **Forge Policies.** Council economists from top to bottom participate in meetings in which administration policies are hammered out. In some of these (such as macroeconomic forecasting or policymaking) the CEA has often taken the lead role; in others (such as antitrust policies or preparing for economic summits) the CEA role has varied from central to nil. One of the most important CEA functions has been policy innovation—such as the active fiscal policies of the early 1960s; their guideposts at about the same time; regulatory reforms in the mid-1970s; or techniques for controlling
inflation in the late 1970s.

5. Economic Analysis. The list of activities suggests that economists at the CEA have abandoned the academy for thoughtless battles in the political trenches. This supposition is wrong. Virtually all the activities at the CEA require professional economic analysis. You cannot forecast the macroeconomy, persuasively advise the President, forge new economic policies, or write the Economic Report without a large stock of accumulated human capital in economics. For the most part, the analysis is elementary: if you have really mastered principles, you have sufficient armor for most battles. Only on few occasions is high-powered analysis used, and in my experience it is seldom useful. The ability to wheel out price theory, trade theory, growth theory, monetary theory, or IS-LM analysis, however, is the only way that an innocent academic can hope to prevail over more seasoned and often more central figures in the political process.

B. WHO IS THE COUNCIL SERVE?

So much for the formal and informal responsibilities of the CEA. Clearly the responsibilities sometimes collide with one another. Generally, the conflict between alternative goals does not break into the newspapers. For example, members of the CEA during the Johnson administration recount that they silently suffered severe misgivings in giving economic advice to a President who was conducting what they thought to be an immoral war. Sometimes, such as most recently during the chairmanship of Martin Feldstein, open warfare erupts between the CEA and the administration in which it is lodged.

Why do such conflicts arise? They arise when a quasi-academic institution with its values and training is inserted in the middle of the political process. There is an inherent tension because the Council is staffed by professionals with academic training and backgrounds. The loyalties of the Council members inhere as much in their profession as in the President or party they serve (the Council staff has very little political loyalty), and the Council views its mission as promoting economic goals. Contrast such a set of values with those of the President's staff, which views its mission to promote the President's political fortunes first, his political ideals second, and the national interest a distant third. In short, the Council is asked to serve two masters, economic progress and political success, and these two often give conflicting
orders.

What should a Council do when faced with conflicting orders? Arthur Okun answers as follows:

When the President's economists decide to go on public record, they cannot serve two masters. They cannot speak both for the President and for the profession. And they cannot speak for the profession publicly and still maintain confidence and rapport internally with the President. The choice should be clear. It is far more important for society and for the profession to have economists who maintain rapport with the President and thus can have greatest influence on the inside.¹

We can formalize our understanding of this conflict by positing a standard principal-agent setup. The principal is the President and his immediate staff, while the agent is the CEA. The principal has a set of objectives—to pass a program, to remain popular, to get reelected—which we denote by the variable, y. The principal wants the agent to help select policies, q, that maximize the President's preference function, \( P(y(q)) \). For example, the President may want the Council's advice on how best to select macroeconomic possibilities to maximize the President's chance of being reelected (as in the theory of the political business cycle).

The agent has a more complicated set of objectives. If he has even a modicum of loyalty, his objectives are not only to help the President (attained by promoting the President's objectives, y), but also to enhance the Council's social-welfare function, \( S(y,x) \), where x is another set of objectives that are distinct from the President's objectives. Hence while the President wants the CEA to maximize \( P(y) \), the CEA will want to maximize \( S(y,x) \). Returning to our example of the political business cycle, the CEA will surely desire its President to be reelected, but it may also view the long-run impacts of attempts to induce a political business cycle to be economically harmful and morally repugnant.

We can visualize the range of agreement and disagreement in terms of how the Council and the administration line up on particular issues, as shown in Figure 1. On any specific issue, the administration and the

GOOD FOR COUNCIL

I. Administration program: no conflict (free trade)

BAD FOR PRESIDENT

II. Conflict of conscience (Vietnam war, supply-side deficits)

BAD FOR COUNCIL

III. Opposition program: no conflict (textile quotas)

IV. Political conflict (deregulation)

Figure 1. Policies generally fall into one of four categories depending on whether Council and president are on the same side, and on whether policies are viewed positively or negatively. In quadrants I and III, there is no conflict. In II and IV, the Council will either have to wrestle with its conscience or with the political forces within the administration.
Council may be for or against. What are the possibilities?

Regime I (Offensive Consensus). In quadrant I of Figure 1, the administration and the Council agree on a measure. It might be the economic expansion in the early 1960s, the war on poverty in 1965, the devaluation of the dollar in 1971, the war on government in the early 1980s, or the tax-reform bill today. The Council would naturally be on the hustings, supporting administration economic policy. No conflict here.

Regime III (Common Defense). A similar situation occurs when the administration and the Council agree that an opposition measure is bad for both politics and for the economy, respectively. Presidents who oppose protectionism always have the CEA fighting the free-trade battle at their sides. Moreover, since Presidents tend to be less concerned about inflation than economists (especially than economists familiar with Weimar Germany), whenever a President decides that curbing inflation by responsible means is warranted, the Council is ready to provide the necessary economic arguments.

More interesting cases are the ones where, after consulting its conscience, the Council decides that its view of the public interest does not coincide with the administration's views. Two subcases are:

Regime II (Conflict of Conscience). In some cases, the Council decides that what is good for the President is not necessarily good for the nation. This case is the most poignant because here (unlike Regime IV) the Council is opposed to an active policy. There are many examples of such conflict in the last 25 years. During the Johnson years, many members of the CEA had strong misgivings about the administration's defense policies. More central was the refusal of the President in 1966 to accept the CEA's call for fiscal restraint. (See the discussion of this episode in Okun, op. cit., Chapter 3.) In this dilemma, the Council chose the strategy, "Nihil nisi bonum," which can be roughly translated as "If you can't support the administration, for God's sake, shut up."

The only viable alternative to the "Nihil nisi bonum" strategy is "If you can't beat 'em, join 'em." How does this arise? In virtually any important economic policy question, the Council will have an opportunity to voice its views. During the Carter years, the Council advocated tax changes to spur business investment (such as extending the investment tax credit to structures). It often lost its arguments to the Treasury, who tended to sniff at impurities in the tax code. In the end, however, the Council was called upon to defend the administration's policy.

How to behave? In answering questions about policy, the Council
chairman cannot say "No comment" or evade questions on important policy questions. Even though he disagrees, he must defend the administration on a large number of issues. The major rationalizations are: (1) on the whole administration policy is reasonable (or at least better than that of the other party); and (2) the theory of the "n"th worse," which states that there are n policies (n very large) that are worse than the administration's policy. In either case, once it recognizes the realities of political economy, the Council can defend administration policy with a good conscience.

Regime IV (Advocacy of Unpopular Ideas). A final stance lies in the northwest quadrant of Figure 1. Often the Council advocates a policy that is thought to be bad for the political health of the administration. In this case, we see the Council in more or less open advocacy of an idea opposed somewhere from the President on down.

Almost all major economic innovations of the last 25 years stimulated this kind of conflict. The idea of using fiscal policy to stimulate the economy was disputed by the orthodox Kennedy treasury for many months. Virtually every policy to contain inflation (from the Kennedy guideposts to the Carter "real wage insurance" plan, except the Nixon price freeze) met widespread resistance in the administrations.

Perhaps the best example of a pure economic idea advocated by the Council and opposed by political forces was the deregulation movement of the mid 1970s. In the beginning, the Council proposed deregulating those industries under price and entry regulation (trucking, railroads, etc.). Political figures to the left and right of the Council attempted to derail these plans. The arguments about deregulation, though, were generally of such low visibility and modest political importance that administrations left the Council to continue their "obsession with markets" without political support. Indeed, Paul MacAvoy ran a one-man university in 1976, giving speeches, sponsoring deregulation conferences and commissions, and advocating legislation with little support from within the administration.

The Carter Council picked up in 1977 where the Ford Council left off. During this period, however, it became clear that the regulatory morass was not just a disconnected series of questionable policies but was a symptom of a structural defect in setting regulatory policies. Just as federal budget policies before the 1920 reforms were unable to piece together a coherent budget policy, so regulatory decisions in the 1970s were the product of a feudal system wherein regulatory agencies issued their diktats without any assurance that these policies fit into a larger
framework. The contradictions were notorious. A meat-packing company was
told by one federal agency to wash its floors several times a day for
cleanliness and by another to keep its floor dry for employee safety. EPA
routinely tells firms not to emit harmful fumes, while OSHA tells firms to
vent smoke to protect workers.

In 1978, the Council proposed a modest centralization of the regul-
atory process in OMB. When regulatory agencies fumed, the political figures
buckled and the regulatory reform was left for the future to handle. More
recently, the Reagan administration has introduced some of the reforms
originally proposed in 1978 as a way of giving greater coherence and presi-
dential direction to regulatory policy.²

PUBLIC DISPUTES

The popular press makes much ado about the differences between the
Council and the administration. My impression is that public disputes have
generally been mild and subdued. Indeed, the battle between the Reagan
administration and the Feldstein Council of 1982-84 is not only unusual but
unprecedented. I know of no occasion in the history of the Council where
there as been as open and profound a dispute between the President and the
Council on such a major issue of economic policy as in the battle over
deficits in recent years. The highwater mark of administration despair
over Feldstein's independence occurred when Secretary of the Treasury
Donald Regan testified before Congress that the Economic Report of the
Council should be thrown into the wastebasket.

One view of the Feldstein imbroglio is that it allowed clarification
on an issue of paramount importance to the nation. Indeed, many in
Congress were grateful to Chairman Feldstein for providing ammunition for
their attacks on the administration's high-deficit policy.

Looking at the period in a longer perspective, this view is mistaken
because it forgets that the Council is economic adviser to the President,
not to the press or the Congress or the people. The Feldstein incident
marked a breakdown in the usefulness of the Council qua adviser to the
President. This dispute arose in part because, in our principal-agent
framework, agent Feldstein placed his own view of the public interest far

²For a more detailed analysis of the problems and for a history of the regulatory reform
efforts over the last decade, see Robert Litan and William Nordhaus, Reforming Federal Regu-
above his loyalty to principal Reagan. He confused his role as adviser with his role as professor. By taking the dispute public, Feldstein lost the trust of the President and of the President's confidants, thereby losing the Council's unique power to affect economic policy by persuading the President in close personal contacts. It is instructive to observe that, in the end, once it had lost the battle for the President's ear, the Council also lost the war to reduce deficits through an aggressive and realistic deficit-reduction policy.

The issues here were wisely summarized by Arthur Okun:

> [C]onfidence must flow two ways. No adviser can expect to have his advice taken all or even most of the time. If he feels in disharmony with the general position and posture of the administration, he ought to leave his job. But if he considers his job worthwhile and is to do it effectively, he must accept certain standards of loyalty. He must agree to confine battling to internal councils and cannot publicly oppose administration decisions once they are made.3

C. CAN IT THRESH?

I was told the story of a salesman who came to a small Kansas town, hawking a miraculous new thrasing machine. He described the new power train, the automated height-setter, the electronic blade-lifter, and other wondrous features. At the end of his spiel, an old hayseed looked at him and asked, "All that malarkey is fine, son. But can it thresh?"

In the end, the central question about the CEA is not whether it has led a tranquil or contentious life, but whether the system has provided the sound economic advice that presidents need to forge wise economic policies.

The first need of providing sound advice is to attract first-rate people. Any examination of the roster of council members and staffs will surely show that the Council has over the years attracted among the best and brightest political economists. A study of economic policymaking in the twentieth century, comparing prewar and postwar economic advisers,

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3Ibid., p. 26 f.
concludes as follows:

As a group, the economists who served on the White House level [of the Roosevelt administration] were much castigated. Tugwell was the most extreme example...[M]any of those who became well known in the Roosevelt years were, to be honest, prime targets for their critics. Tugwell was arrogant and a political ignoramus. His book The Brains Trust, written thirty years later, leaves no doubt on both counts!...The professional shortcomings of the New Dealers become obvious when compared to their successful modern-day counterparts: Walter Heller, Gardner Ackley, Paul McCracken, and Paul Samuelson.4

But good men and women are not enough, as the Feldstein episode shows. Was economic advice more effectively transmitted, so that economic policy was wiser and the economy more stable, without the Council? This counterfactual exercise is, of course, impossible to answer definitively, but the economic record indicates that the Council has helped to foster better economic performance. On the surface, the postwar period has been far stabler than the prewar period, both in terms of inflation and unemployment stability. Moreover, when major economic shocks occurred (as in 1950, 1973, and 1979), the Council helped to fashion policies that, while always subject to dispute, were surely not palpably nonsensical.

We can recall the flounderings of Hoover and Roosevelt in the prewar period to see how poor policy can be without competent economic advice and a channel for transmitting it. Hoover's main economic accomplishments were the passage of the Smoot-Hawley tariff over the objection of virtually the entire economics profession and increasing taxes to curb a depression-bloated deficit. Recall that in the early days of the Roosevelt administration, he increased taxes, raised the price of gold in the hope of raising the price level, curbed agricultural production, and organized cartels to maintain profit margins! Such uninformed demarches are largely absent from the postwar scene.

In order to see whether the existence of a strong CEA was conducive to better economic performance, I examined periods during the twentieth

century when the CEA was and was not influential in the setting of economic policy. For this purpose, I include as periods of influence the entire period since 1946 with two exceptions. The Nixon years are omitted from the "CEA period" because the Treasury and White House staffs tended to wield the upper hand in economic policymaking. Why were these years omitted? It is clear that the major economic policy of the Nixon administration--the August 1971 measures--was largely the brainchild of Treasury Secretary Connolly (see Herbert Stein, Presidential Economics, Simon and Schuster, New York, 1984, Chapter 5; and Robert Solomon, International Economic Policy, p. 185). Shortly afterwards, an intimate told CEA member Stein, "Ideologically, you should fall on your sword" (see Stein, Ibid., p. 179).

In addition, the Reagan administration is omitted from the "CEA years," for during this period the major economic policy steps were taken without the consent, and often without the advice, of the Council. The story of this period--how the Reagan policies led to the greatest fiscal fiasco in recent American history--is known in broad outline. During his candidacy in 1979-1980, Reagan had a conservative but broad group of advisers of which only Arthur Laffer and Jack Kemp were hard-core, tax-cutting supply-siders. When the major economic-policy speech was written (in September 1980), it appeared that there was sufficient budget margin by the mid-1980s to allow both a major defense buildup and tax cuts. Hence in that key speech, candidate Reagan endorsed a major tax cut along with "consistency" in economic policymaking. As the fiscal room for maneuver began to disappear in 1981, President Reagan delivered on both promises, with his CEA showing great discomfort over the potential impact on future budget deficits.

Turn then to a comparison of the "CEA" period with the "no CEA" period. Obviously, there were other major differences in economic affairs during this period, such as the presence of absence of oil shocks, flexible exchange rates, or knowledge about The General Theory. Just as the competence of a doctor is judged by the life or death of a patient, similarly the bald facts about economic performance are hard to avoid in judging the performance of a nation's economic advisers.

A comparative record of the two periods is shown in Table 1. By most measures, the "CEA" period showed markedly better performance than the "no CEA" period. During the "CEA" period, the unemployment rate was lower and less volatile; output growth was less variable; inflation was less variable; the debt-GNP ratio declined as compared to an increase during CEA-
<table>
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<tr>
<th>Economic Performance</th>
<th>Period when CEA was influential(a)</th>
<th>Periods with no or weak CEA(b)</th>
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<tr>
<td>Real GNP</td>
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<td>Growth(c)</td>
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<td>Inflation (CPI)</td>
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<td>Rate(c)</td>
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<td>Variability(d)</td>
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<td>Variability(f)</td>
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<td>Change in Debt/GNP ratio(g)</td>
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(a) 1947-69, 1974-80.
(b) 1900-1946, 1970-73, 1981-84.
(c) Average annual percent change.
(d) Standard deviation of annual average percent change.
(e) Percent of labor force.
(f) Standard deviation of unemployment rate.
(g) Annual average percentage change in ratio of federal debt outstanding to GNP.
absent years. The only poor grade for the CEA lies in the average rate of inflation, which was clearly higher when the CEA was influential. Nor is the association of the "CEA" period with inflation surprising given the fact that CEAs have generally told Presidents how to stimulate the economy and have seldom succeeded in persuading Presidents to contract the economy.

Not only was economic performance superior with an influential CEA, but it can also be argued that the major economic blunders of the postwar period were ones undertaken largely without the advice or over the objections of the Council. Three episodes that stand out in the light of hindsight as major errors are the postponement of fiscal restraint in the mid-1960s, the imposition of wage-price controls in 1971, and the deficit-inducing policies of 1981. In the first case, the Council's recommendation for a tax increase--privately voiced in the winter of 1965--was overridden on political grounds by President Johnson. In the second case, the price-wage controls were generated by the Treasury and White House; the CEA was brought onto the scene only at the last moment. In the third case, the decision on the large tax cut was effectively taken in September 1980, before President Reagan had set up his CEA -- the Council's misgivings in early 1981 and thereafter were unavailing.

On the whole, I would count the creation and survival of the CEA as a positive force in the American economy. Of course there have been struggles. Who can be surprised that conflicts arise between the CEA and the administration? They arise between any narrowly focused group (and economics is surely narrow) and a broadly focused political institution like the presidency. But the CEA has weathered the conflicts and has emerged with its honor and institutions intact. It continues to be poised at a point where future presidents, should they care to listen to economists who put pen to paper rather than to napkins, can call the CEA chairman and receive a professional but sympathetic analysis of economic trends and policies.