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*Fiscal Policy  
and Housing*

GARDNER ACKLEY

My purposes in this paper are essentially expository, rather than to present the results of any research. However, it is my personal conviction that there is sufficient confusion about some aspects of housing policy to make an expository paper appropriate, especially by way of introduction to the program of this Conference.

I was asked to talk about how fiscal policy can help us to achieve our housing goals, but I can obviously not deal with that subject in isolation. I shall therefore discuss the following topics, in this order:

1. The nature of our national housing goals, and the importance of policies other than general fiscal, monetary, and financial policies in achieving them.
2. The contributions of general fiscal and monetary policies, and the relationships between them.
3. The relationship of fiscal and monetary policies to the problem of housing finance.
4. Some crude quantification of the magnitude of the fiscal policy requirement for meeting the housing goals.

*Our Housing Goals*

I am sure that all of you recall the nature and magnitude of our national housing goals, so I will review them only very briefly. Those goals, in fact, are two: between fiscal years 1968 and 1978, the production of six million subsidized new or rehabilitated units,

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which will provide better housing for low income families than they could otherwise afford; and, over the same period, the production of a total of 26 million units, including the six million subsidized units. Let me say at once that I will not address myself to the question whether we should have national housing goals as specific as these, or whether these particular goals are appropriate ones. Rather, I am asked to discuss what would be necessary to achieve them.

The first part of the housing goal is obviously of a quite different character from the second, and so are the policies necessary to achieve it. These policies are largely independent of general fiscal, monetary, and financial policies. Needed, rather, are effective legal and administrative mechanisms for supplementing the resources of low income families, and budgetary appropriations adequate to carry them out. It is my impression that this part of the goal by itself presents little problem. According to Charles Schultze,<sup>1</sup> the levels of subsidized construction provided for in the fiscal 1971 budget are already at or close to those needed to achieve by 1978 the six million units required. Provisions in previous budgets have already started a great many of these subsidized units through the exceedingly long administrative pipeline. Now that the Administration has reduced from two million to one million the goal for subsidized rehabilitations—which I gather offer the greater administrative and other difficulties—and substituted another million of subsidized *new* units, it is apparently primarily a matter of maintaining an adequate level of subsidy appropriations. This is not to say that the particular means of subsidization that we are using are necessarily the best. Indeed, I seriously question whether they are. But we can produce six million subsidized units.<sup>2</sup>

The more difficult questions relate to the overall goal of 26 million units during the decade. To be sure, this goal seems somewhat less ambitious, now that it has been scaled back by the present Administration's reinterpretation of it to include mobile homes, of which four million are expected to be shipped during the decade. However, one of our most able and perceptive housing

<sup>1</sup> *Setting National Priorities: The 1971 Budget*. The Brookings Institution, 1970, pp. 86-91.

<sup>2</sup> We could, of course, provide subsidies to six million families without building six million—or even 600—new units for them to live in. But for a number of reasons, we feel that we must provide new or rehabilitated units specifically for the purpose of housing subsidized families. That is, the subsidy is tied to a dwelling unit, not to a family.

analysts—Anthony Downs—two years ago flatly predicted that the original goal would not be met, and this was before the depression of housing starts of 1969-70.<sup>3</sup> The arithmetic alone is rather staggering. Two of the 10 fiscal years are now completed. During those two years we have produced about 2,900,000 conventional units, and 800,000 mobile homes. That leaves about 19,000,000 conventional units for the remaining eight years, or about 2,400,000 a year, and 3,200,000 mobile units. So far as conventional houses are concerned, this is 70 percent higher than our average rate of homebuilding during the 1960's.

Downs presents a formidable list of obstacles to the construction of this many homes. They relate to the industrial organization of the construction industry, to the supply of trained construction workers, to the design of Federal subsidy and financing programs, to the procedures for compensation and relocation of persons displaced when urban land is cleared for new housing, to the policies to open up the suburbs (where land must be found for *most* of the new housing), to building codes, to technical and economic research—among a great many other things. Downs does not say that the housing goal cannot be met, merely that it would require giving the housing problem a higher priority—among other urgent problems—than the American people are likely to give it once they see what is involved, and a higher priority than Downs thinks they probably should give to housing.

For our purpose, we do not need to examine Downs' list of obstacles nor the policies which he or we might suggest to overcome them. Rather, I refer to it merely to remind us all that the availability of generalized resources on the scale which we might calculate was needed to build 26 million houses, and financial mechanisms for assuring that adequate savings are available in the form needed to finance housing, do not themselves get houses built. It would be folly to free the generalized resources that we calculate are needed until we are sure that the incentives and the indispensable specialized resources of raw materials, labor, land, technology, public administration, and private entrepreneurship are available in the magnitudes necessary to build that many houses.

<sup>3</sup> "Moving Toward Realistic Housing Goals," in *Agenda for the Nation*. K. Gordon, ed., The Brookings Institution, 1968.

*Fiscal and Monetary Policy and Housing*

I come now to the contribution of fiscal policy to meeting our housing goals.

In recent years, quite a bit has been said and written on the impact of fiscal policy on residential construction, some of it relevant and correct, and much of it—in my view—less so. For example, it is sometimes held that an (inappropriately) expansionary fiscal policy during 1966-68 somehow inevitably and automatically squeezed housing construction. I prefer to say not that it was an overly expansionary fiscal policy which squeezed housing; rather, that it was a highly restrictive general monetary policy (impinging on some particular institutional aspects of our financial system) that affected housing so adversely. You may consider my reservations on this score purely semantic. Given the fiscal policy, you may say, monetary policy had no choice but to be highly restrictive.

I happen, on balance, to be glad that our monetary managers did decide to do something to make up for the clear deficiencies of our fiscal policy. But they didn't have to. It wasn't inevitable. They could have done something else, which might have let inflation run its course. In that case, it is not clear to me that housing would necessarily have been adversely affected—certainly not to the extent that it was. Or the Fed could have pursued a highly selective monetary policy designed primarily to affect other forms of credit-financed expenditure.<sup>4</sup> Or the Congress might have adopted direct price and wage controls, with or without some form of allocations or rationing, applied either to the use of credit or of other resources in various industries or to the purchase of various kinds of output. Unpalatable as some or even all of these alternatives may seem, the word policy has no meaning if it doesn't imply choice among alternatives. The Fed did choose (with or without the consent or the urging of the Administration) a highly restrictive general monetary policy, and I say that this is what “clobbered” housing.

Let us take the reverse case. Suppose that fiscal policy at some stage becomes “inappropriately” restrictive—judged by your or my standard of what is “appropriate”. Would you hold that this makes inevitable an extremely easy general monetary policy, which

<sup>4</sup>This might have required some legal authority which the Fed does not have. But the fact that it has not sought such authority is itself a policy decision.

(especially given our institutions) would also tend to be highly stimulative of private housing? And should we say, therefore, that, if this happened, it was the restrictive fiscal policy that stimulated housing? I am tempted to believe that, at least in this case, you would respect my preference to distinguish among the separate impacts of separate policies.

*What is a Neutral Monetary Policy?*

The real source, I rather think, of much of our semantic confusion in these matters is that we have never agreed (so far as I know) on what is a “no policy” or a “neutral policy” at least so far as monetary policy is concerned. This, I think, is unfortunate. If fiscal policy is shifted toward tightness or toward ease,<sup>5</sup> this fact has impacts on the variables which monetary managers must consider. If we could agree to define (however arbitrarily) what would be a “no response” to these new circumstances, we could then define what is a policy response. Without a definition of neutrality, we cannot define non-neutrality—i.e., a policy.

Now one familiar line of thought would, I believe, define a neutral monetary policy as one which would promote a steady change in the money supply (or in reserve assets) at a rate of  $X$  percent per annum.<sup>6</sup> If the Central Bank were to maintain neutrality on this definition—by achieving a steady, unchanged advance of  $M_1$  or  $M_2$ —then, when fiscal policy became more or less restrictive, fiscal policy would indeed have predictable impacts on the general level of interest rates, and, given the particular institutional structure, predictable impacts on mortgage rates, the availability of mortgage funds, and the volume of residential construction.

We could then, in principle at least, figure out what fiscal policy would be necessary in order to achieve any given rate of residential construction, assuming monetary policy were neutral. Unfortunately,

<sup>5</sup>This expression implies that we have a standard of neutrality in so far as fiscal policy is concerned. Many of us would express it as no change in the full-employment surplus.

<sup>6</sup>Some of those who support this definition of neutrality would also advocate the adoption of the neutral “no-policy” as a permanent monetary policy—carried out, if possible, by the programmed responses of a computer.



if our goal were a high rate of residential construction, and if X (the growth rate of money) were a moderately low number, I suspect that the fiscal policy necessary to achieve our goal--if it could be achieved at all--would then be one which required heavy unemployment and stagnation of overall production.<sup>7</sup> It would be much easier if monetary policy were to contribute actively to the result. We have known for quite a while that if we have two goals--in this case, housing and full employment--we really need to have at least two policy tools.

However, a steady growth of the money supply is not the only conceivable definition of a neutral monetary policy, nor is it even the one I think I would prefer. Another possible definition of neutrality would run in terms of no change in some particular interest rate.<sup>8</sup> If monetary policy remained neutral on this definition, fiscal policy would still affect the overall economy--and have to take most of the blame for inflation or unemployment. But because most interest rates would be quite stable, fiscal policy could have relatively minor impacts on the volume of housing. Unless the "neutral" interest rate were quite low, achieving an ambitious housing goal would be impossible without an actively stimulating monetary policy.

However, *defining* monetary neutrality and *having* a "no-policy" monetary policy are two quite different things. I am very much in favor of an active, discretionary monetary policy. But in order to know when it is monetary policy that is at work and when it is fiscal policy, or both, we do need definitions of neutrality for each of them. Without that, I do not see how we can intelligently communicate with each other. For instance, we find ourselves

<sup>7</sup>We could, of course, (and some do) define a steady growth of M as a neutral monetary policy and advocate setting the dials once and for all at the neutral positions for both monetary and fiscal policy. This view, traces of which appear in the Council of Economic Advisers' *Annual Report* for 1970, rejects nearly everything economists have learned for a century or more--and particularly in the past 35 years--about the sources of instability in private spending and the ability of prices, wages, and interest rates to counter these forces of instability. However, this is only tangential to the subject of my paper, so I shall leave its discussion for another time.

<sup>8</sup>This is also a "no-policy" policy that could be programmed into a computer. It would stabilize the interest yield on some Government security--by buying and selling that security freely at fixed prices.

assuming--or denying--that fiscal policy determines interest rates. Further, without such definitions, we cannot unambiguously assign blame or credit to the makers of fiscal and monetary policy. All this might be unnecessary if *one* agency were responsible both for monetary and fiscal policy decisions. But when, as is presently the case, the responsibility is divided, the absence of such definitions can lead not only to confusion, but perhaps also to significant policy failures. If, as now, both authorities operate under a single mandate (presumably that of the Employment Act, as presently reinterpreted), is it neither that is responsible when that mandate is not fulfilled? Or is it both?

### *Can Fiscal Policy Contribute To Housing Goals?*

How, then, can fiscal policy best contribute to meeting our housing goals? By itself, it seems to me, it can contribute very little. I would thus disagree rather profoundly with one form of statement which claims that fiscal policy--by being sufficiently restrictive--can do a great deal for housing. It runs this way:

Fiscal policy can contribute to the achievement of our housing goals by providing a sizeable full-employment surplus. This surplus is needed not to prevent inflation, but because it generates saving. The funds accruing from a Federal surplus will be poured back into the capital markets, where they can be used to finance housing. As residual claimant in the capital markets, housing stands at the far end of the trough. But if enough savings are poured in, there will be enough left over for housing.<sup>9</sup>

One thing we know, however, is that savings does not create investment. You don't get houses built simply by depressing aggregate demand. If some other force does not stimulate housing, the houses won't be built, the economy will slump, and the hypothetical full-employment budget surplus will turn into a low-employment actual budget deficit.

On the other hand, if the ambitious housing goal is met, then, without a sizeable full-employment surplus, aggregate demand might well be excessive, and inflation would result. It is precisely to avoid

<sup>9</sup>I am sure that, given a little time, I could find almost precisely these words in statements of some policy makers and some leading members of the financial community.

inflation from excessive demand--assuming the houses *are* built and that other sources of aggregate demand are at "normal" levels--that the full-employment surplus would be needed. The contribution of fiscal policy is not to get houses built but to reduce sufficiently *other* demands on our resources when and to the extent that another set of policies stimulates housing.

Sometimes I tell myself that everybody knows this. I shouldn't get so excited when people engage in a bit of shorthand that everyone understands. But other times I am not so sure. On last February 9, the members of the Council of Economic Advisers appeared before the House Committee on Banking and Currency to discuss "economic aspects of the housing situation." I quote the concluding sentence of their prepared statement, which is also one of its principal themes: "The most basic contribution that Government can make to housing is a substantial budget surplus, on an on-going basis, that will assure adequate financing at reasonable interest rates for the economy's total investment needs."

### *What Policies Are Needed?*

This form of statement tend to divert attention from policies that are really needed in order to get houses produced--policies which do *not* consist merely of the provision of a budget surplus. (I hasten to add that the Council's own attention was not so diverted. It did discuss many of the other policies that are needed.) A second trouble with it is that it contributes to confusion about the relative roles of monetary and fiscal policies, by implying that it is fiscal policy that determines interest rates, a point which I have already beaten to death. But a third trouble with it is that it can lead to what I think is bad policy advice under conditions of less-than-full employment. I quote further from this statement.

... The Administration's goal [for 1970], as stated in the President's Economic Report, is to 'permit residential construction to revive and begin a rise toward the path of housebuilding required by our growing number of families needing homes and apartments.' A critical part of a combination of policies to achieve that is the moderate budget surplus projected for fiscal 1970 and 1971. It is hard to conceive of anything that would so certainly block the revival of housing as the return of budget deficits, forcing the Federal Government into the capital markets again as a net borrower. Indeed, the outlook for housing in 1970 and 1971 would be much brighter today if a larger surplus were in prospect. The tax reductions going

into effect this year, which substantially exceed the Administration's recommendations, have now made that impossible. Indeed, only with Herculean efforts to hold down expenditures was it possible to project the small surplus for fiscal 1971.

We believe that the budget surplus, combined with the moderation of monetary restraint which should become possible, and a continued high rate of support for the mortgage market by FNMA and FHLBB projected in the budget, should provide the financial conditions for a revival of housing starts during fiscal 1971.

Now a larger prospective budget surplus in 1970 and 1971 may possibly have seemed desirable to the Council in order to depress economic activity farther below potential, thereby (probably) reducing more rapidly the rate of inflation. But did it really want a different level of aggregate activity, or a different mix of housing and other outputs? Was a larger surplus really needed in order to provide saving to finance housing? If there had been to Tax Reform Act and it had been possible to program a larger surplus, would the prospects for housing *really* have been brighter? Did the Council *really* want a larger surplus, or a larger surplus coupled with an appropriately easier monetary policy? When, in fact, the programmed surplus turned into a deficit because the economy was much weaker than expected, did this depress housing starts? If so, was it by reducing the pool of available savings, or for some other reason? Would housing have been helped if, when demand slumped, tax rates had been increased or Federal expenditures reduced in an effort to restore the surplus?

I ask these questions that seem to me to be raised by this statement of the Council not because I am critical of the degree of sophistication of its public pronouncements--which on the average contain probably no more and possibly less pabulum than is found in those of earlier Councils--but rather to help us here to clarify our own thoughts and expression. Let me state how I think the relationship of fiscal policy to housing should be put.

### *Relationship of Fiscal Policy to Housing*

One determinant of housing demand and thus of housing production is aggregate disposable income. *Ceteris paribus*, housing will be larger, the higher the level of disposable income. Disposable income is a determinant which fiscal policy can clearly affect. Other, doubtless more important, determinants are the level of mortgage interest rates and the supply of mortgage credit. These are



determinants which monetary policy can primarily affect. I realize that these statements are ambiguous until one defines a neutral monetary (and fiscal) policy. But, ambiguous as they are, I think that most of you would understand and perhaps even accept them.

If our goal were to maximize housing construction and we had only these two tools--general monetary and fiscal policy--I would prescribe their use as follows. First: determine what level of aggregate output and employment seems to provide the desired balance between high employment and price stability objectives. Second: make monetary policy as easy as possible (I have in mind potential limitations relating to international capital flows, and perhaps others). Third: figure out how much housing (and other forms of investment) can be expected to be forthcoming with that monetary policy at the desired level of output. Fourth: set fiscal policy in such fashion as to produce the desired level of employment and output, given the housing projection and the expected inherent strength of all other elements of private and state and local government demand (including, of course, the impact of the projected monetary policy on other forms of investment).<sup>10</sup>

These calculations may imply a sizeable full-employment budget surplus. If so, the reason for this surplus is to avoid undesirable inflation, not because a higher level of aggregate demand would necessarily reduce housing. If we should want to avoid the "fine

<sup>10</sup> I am grateful to Warren Smith for pointing out that, to the extent that an easy monetary policy stimulates other forms of investment as well as housing, this means that we get more houses only by also getting more investment in, say, plant and equipment. To avoid inflation, fiscal policy must then reduce consumer spending by enough to make room at full employment both for the added housing and for the added production of plant and equipment. But we may not want more plant and equipment spending. The combination of two policies--monetary and fiscal--works to permit achievement of two goals (more housing and full employment without inflation) because and to the extent that fiscal policy operates primarily--though not exclusively--on consumption rather than housing, while monetary policy operates mainly on housing and secondarily (if at all) on consumption. But we also have a third use of resources--business investment--which our monetary policy will probably stimulate more strongly than our fiscal policy will restrain. To achieve a desired balance among three classes of output, we need at least one more policy tool. Or perhaps we should conclude that general monetary and fiscal policies are simply instruments too blunt to use to determine both the composition as well as the level of output, and that we should find more specific tools to do the former.

tuning" of either fiscal or monetary policy, these calculations should be made on the basis of expected averages over a three to five year period. Or, fiscal policy could be set on that basis and monetary policy varied for stabilization purposes. But the principles are still essentially the same.

### *The Role of Finance*

As I have described the role of fiscal policy, it is essentially that of freeing sufficient generalized resources of labor, materials, and enterprise to build the houses that other policies--including monetary policy--can stimulate and facilitate. This way of putting it says nothing about "finance." Has the pool of savings argument no relevance?

In my view, essentially none. We all know that gross saving and investment are always and inevitably identically equal, and that, moreover, in "equilibrium"--whatever that precisely means--the total of the "desired" or "willing" or "planned" saving of the nation must equal the total of its "desired" or "planned" investments. The problem of housing finance is not basically one of providing an adequate volume of total saving. Rather, it is one of the allocation of that saving. Although our financial intermediaries do an excellent job of shifting saving flows among various uses through relatively minor changes in relative interest rates, our institutions are such that--particularly when money is tight--housing faces either a sharp rise in the *relative* as well as absolute interest rate it pays, or the rationing of credit supplies. Some of these institutional obstacles operate less severely when general monetary policy is easier. Still, the sharp increase in the volume of residential mortgages which seems to be implied by the housing goals could cause problems. New or altered financial institutions can permit the necessary shift of funds to housing with a minimum *relative* deterioration of the terms on which housing is financed. This means that other policies--including, particularly, the easing of general monetary policy--will not have to be pushed so far as otherwise in order to encourage the desired volume of housing production. The task of fiscal policy, however, is best thought of as that of freeing resources from other uses, not that of providing saving.

*The Magnitude of the Fiscal Requirement*

My final purpose in this paper is to provide some rough estimates of how large a full-employment surplus would be needed in order to restrain inflation in the years ahead--on the assumption that our housing goals are fully achieved, through whatever combination of policies is necessary to accomplish this. Would it require a full-employment surplus well outside our range of past experience?

I have limited my calculations to fiscal years 1975 through 1978. My reason is that it seems to me highly unlikely that full employment will be restored prior to then. Even assuming that a 4 percent annual rate of real GNP expansion can be achieved during the first half of calendar 1971 (which seems to me highly optimistic), and 5 percent in the second half, a rate of real GNP expansion averaging just over 6 percent a year would be needed over the subsequent 2½ years to reach potential output by the second half of calendar 1974.

I believe that I could demonstrate that, during this period of rapid climb toward full employment, *both* the targets levels of housing starts *and* a reasonably permissive fiscal policy would be *needed* in order to achieve the necessary real growth of aggregate demand. Put another way, during this period, the probable weakness of business fixed investment spending, and the continuing decline in real defense spending will leave free all the resources needed to produce the target levels of housing without requiring any diversion of resources away from consumer spending, state and local purchases, and non-defense Federal purchases. In any case, projections for this period are more complex than for the period after full employment is regained, when the economy can be assumed to be moving smoothly along a path of potential output.

I have tried to prepare mutually consistent estimates of the volumes of all items of gross saving and of all categories of gross investment--including residential construction at target levels--in a full-employment economy in 1975-78 (all as defined in the U.S. National Income and Product Accounts). The Federal surplus is computed as the residual needed to equate gross saving and investment. The following tabulation summarizes the basis for each of the estimates.

*Potential real GNP*--estimated by extrapolating the projections now available through calendar 1975 at an annual rate of growth of 4.3 percent.

*GNP deflator and GNP in current prices*--the rate of increase in deflator assumed to slow gradually to 2.5 percent by second half of 1973 and to remain at that rate.

*Residential construction expenditure in current prices*--construction cost estimates (less land costs and mobile homes) taken from President's *Second Annual Report on Housing Goals*, revised to a deflator in line with (but increasing more rapidly than) my assumed general deflator, and adjusted to consistency with GNP residential construction account for fiscal 1969.

*Business fixed investment*--two alternative estimates (and, correspondingly, two estimates of the necessary Federal full-employment surplus): the first takes real business fixed investment at 11.3 percent of real GNP--the highest annual percentage for any year since 1948; the second uses 10.0 percent--the lowest in any high-employment year since 1953; estimates inflated to current prices by a deflator related to and rising slightly less rapidly than the assumed GNP deflator.

*Change in inventories*--taken at 0.75 percent of current dollar GNP, about average for the period 1953-69.

*Net foreign investment*--assumed at 0.6 percent of GNP, close to its record high.

*Capital consumption allowance*--projected as a percentage of current-price net dollar stock of private structures plus producers' durables, extended through 1978 on perpetual inventory basis; depreciation percentage extrapolates the steady upward trend (since the 1962 depreciation reforms) of the percentage which CCA is of the current-price stock.

*Undistributed profits and IVA*--corporate profits before taxes taken as 10.5 percent of current-price GNP, corporate profits taxes at present rate, and dividends at 45 percent of after-tax profits.



*State and local government surplus*--taken as zero, above its average value in recent non-recession years.

*Personal saving*--taken as 8.3 percent of personal disposable income, less projected consumer interest (consumer spending has averaged 91.7 percent of disposable income since 1947; a bit less than that during the 1960's); disposable income projected from current-price full-employment GNP, projected capital consumption allowances, projected corporate undistributed profits, and projected Federal and state and local government surpluses and purchases (which between them imply aggregate taxes, social insurance contributions, transfers, government interest, and subsidies less current surplus).

*Statistical discrepancy*--projected at 1970 level.

*Federal government surplus*--two residuals, consistent with the two levels of business fixed investment; estimated simultaneously with personal saving which depends (inter alia) on the size of the surplus.

My projections and assumptions are summarized in Tables 1, 2, and 3. So far as I can see, they show no need for any great diversions of resources to be accomplished through a restrictive fiscal policy. Given the *high* projections of business fixed investment, a Federal full-employment surplus averaging \$8.2 billion is needed in fiscal years 1975 through 1978; given the *low* projections of business fixed investment, a Federal full-employment *deficit* averaging \$12.9 billion is appropriate. The best estimate presumably lies somewhere within this range. The two figures are respectively 0.6 percent and -0.8 percent of GNP. According to Okun and Teeters,<sup>11</sup> we have had full-employment surpluses of 0.5 percent or more of potential GNP in 11 of the past 14 years. Thus the finding is hardly very startling.

The really significant fact is that--as tremendous an effort as seems to be implied by housing starts averaging 2.4 million over the next eight years, it is not a significantly large effort in a rapidly growing economy. To be sure, housing starts have been shrinking relative to the size of the economy for two decades. But even at the target

levels, residential construction would average only 4.1 percent of GNP in 1975-8. It was a higher percentage in every post-war year until about 1964.

I have no great confidence in my particular projections of the needed Federal full-employment surplus. But I have sufficient confidence in their general orders of magnitude to conclude that there has probably been a certain amount of wasted rhetoric dispensed on the subject of how much fiscal discipline is going to be necessary if we are ever to meet our housing goals.

My impression is that some of the other contributions to meeting our housing goals are going to prove far more vital and far more difficult than the contribution that fiscal policy may be called upon to make.

<sup>11</sup>"The Full Employment Surplus Revisited," in *Brookings Papers on Economic Activity*: 1, The Brookings Institution, 1970.



TABLE 1

**GROSS NATIONAL PRODUCT, GROSS SAVING, AND GROSS INVESTMENT  
1966-69, AND PROJECTIONS FOR 1975-78  
(ALL DOLLAR FIGURES IN BILLIONS AT CURRENT PRICES)**

	CALENDAR YEARS				PROJECTIONS—FISCAL YEARS							
	1966	1967	1968	1969	1975		1976		1977		1978	
					H	L	H	L	H	L	H	L
GNP in Current Prices	749.9	793.9	865.0	931.4	1413.3		1510.9		1615.3		1726.8	
Business Fixed Investment	81.6	83.3	88.7	99.3	151.7	134.2	162.2	143.6	173.4	153.4	185.3	164.1
Residential Construction	25.0	25.1	30.3	32.0	61.2		63.5		65.4		66.4	
Net Foreign Investment	2.4	2.2	-.3	-.9	8.5		9.1		9.7		10.4	
Change in Inventories	14.8	8.2	7.6	8.5	10.6		11.3		12.1		13.0	
Total Gross Investment	123.8	118.8	126.2	138.9	232.0	214.5	246.1	227.5	260.6	240.6	275.1	253.9
Capital Consumpt. Allow.	63.9	68.9	74.0	78.9	117.7		128.1		139.0		151.0	
Undistributed Profits + IVA	27.4	24.1	21.6	18.5	45.7		49.0		52.5		56.1	
State & Local Gov't Surplus	1.3	-1.6	-1.1	-.6	0		0		0		0	
Personal Saving	32.5	40.4	40.4	37.6	57.9	59.5	62.3	63.9	67.5	69.3	72.8	74.7
Federal Gov't Surplus	-.2	-12.4	-6.2	9.3	15.3	-3.8	11.4	-8.9	6.3	-15.5	-0.2	-23.3
Statistical discrepancy	-1.0	-.7	-2.4	-4.7	-4.6		-4.6		-4.6		-4.6	
Total Gross Saving & Statistical Discrepancy	123.8	118.8	126.2	138.9	231.9	214.5	246.1	227.5	260.6	240.6	275.1	253.9

NOTE: Columns headed "H" are based on a high projection of business fixed investment; those headed "L" on a lower projection (see text).

TABLE 2

**GROSS SAVING AND GROSS INVESTMENT  
AS PERCENTAGES OF GROSS NATIONAL PRODUCT  
1966-69 AND PROJECTIONS FOR 1975-78**

	CALENDAR YEARS					PROJECTIONS—FISCAL YEARS									
	1966	1967	1968	1969	Average 1966-69	1975		1976		1977		1978		Average 1975-78	
						H	L	H	L	H	L	H	L	H	L
Business Fixed Investment	10.9	10.5	10.3	10.7	10.6	10.6	9.5	10.7	9.5	10.7	9.5	10.7	9.5	10.7	9.5
Residential Construction	3.3	3.2	3.5	3.4	3.4	4.3		4.2		4.0		3.8		4.1	
Net Foreign Investment	.32	.28	-.03	-.10	.12	.60		.60		.60		.60		.60	
Change in Inventories	1.97	1.03	.88	.91	1.2	.75		.75		.75		.75		.75	
Total Gross Investment	16.5	15.0	14.6	14.9	15.3	16.4	15.2	16.3	15.1	16.1	14.9	15.9	14.7	16.2	15.0
Capital Consumpt. Allow.	8.5	8.7	8.6	8.5	8.6	8.3		8.5		8.6		8.7		8.5	
Undistributed Profits + IVA	3.7	3.0	2.5	2.0	2.8	3.2		3.3		3.3		3.3		3.2	
State & Local Gov't Surplus	.17	-.20	-.13	-.06	-.05	.0		.0		.0		.0		.0	
Personal Saving	4.3	5.1	4.7	4.0	4.5	4.1	4.2	4.1	4.2	4.2	4.3	4.2	4.3	4.2	4.3
Federal Gov't Surplus	-.0	-1.6	-.7	1.0	-.4	1.1	-.3	.8	-.6	.4	-1.0	.0	-1.4	.6	-.8
Total Gross Saving and Statistical Discrepancy	16.5	15.0	14.6	14.9	15.3	16.4	15.2	16.3	15.1	16.1	14.9	15.9	14.7	16.2	15.0

NOTE: Based on data from Table 1.



TABLE 3

SUPPLEMENTARY SERIES: DEFLATORS, PROFITS, DIVIDENDS,  
GOVERNMENT PURCHASES, CONSUMER INTEREST

	CALENDAR YEARS				PROJECTIONS—FISCAL YEARS			
	1966	1967	1968	1969	1975	1976	1977	1978
GNP Deflator <sup>1</sup>	113.9	117.6	122.3	128.1	154.0	157.9	161.8	165.9
% change from previous year	2.7	3.2	4.0	4.7	2.5	2.5	2.5	2.5
Residential Construction Deflator <sup>1</sup>	117.4	123.1	129.7	137.7	172.8	178.4	184.2	190.2
Ratio RC Deflator to GNP Deflator	1.03	1.05	1.06	1.08	1.12	1.13	1.14	1.15
Business Fixed Investment Deflator <sup>1</sup>	110.2	113.8	117.5	122.8	146.3	150.0	153.7	157.6
Ratio BFI Deflator to GNP Deflator	.97	.97	.96	.96	.95	.95	.95	.95
Federal Purchases Deflator <sup>1</sup>	118.8	121.5	126.4	133.9	161.7	165.8	169.9	174.2
Ratio Fed. Purch. Deflator to GNP Deflator	1.04	1.03	1.03	1.05	1.05	1.05	1.05	1.05
Corporate Profits Before Taxes <sup>2</sup>	84.2	79.8	88.7	91.2	148.4	158.6	169.6	181.3
Corporate Profits After Taxes <sup>2</sup>	49.9	46.6	48.2	48.5	85.0	90.9	97.2	103.9
DIVIDENDS <sup>2</sup>	20.8	21.4	23.3	24.7	38.3	40.9	43.7	46.8
IVA <sup>2</sup>	-1.8	-1.1	-3.3	-5.4	-1.0	-1.0	-1.0	-1.0
Federal Gov't Purchases <sup>2</sup>	77.8	90.7	99.5	101.3	113.2	119.4	125.7	134.1
State & Local Gov't Purchases <sup>2</sup>	79.0	89.4	100.7	110.8	184.7	203.2	223.5	245.8
Consumer Interest and Transfers Abroad <sup>2</sup>	13.0	13.9	15.0	16.5	22.0	23.0	23.6	24.2

<sup>1</sup> 1958 = 100<sup>2</sup> In billions of dollars, current prices.

## DISCUSSION

JAMES S. DUESENBERY

As Gardner said, I was his student, and I have found that I've been able to learn things from Gardner all along, and still am able to learn something this morning. In fact, I am in a little bit of a difficulty because I've always found that the ideal paper to discuss is one that is wrong in some interesting way, but unfortunately, as far as I can see, Gardner's paper is basically right, and that doesn't leave me a lot to say. All I can do is to reinforce a couple of points that Gardner made, add a couple of quibbles, and then raise with you one problem which has come to my mind after having read this paper.

I think there is no question about the basic logic that Gardner has put before you. Our problem in trying to achieve a housing goal makes sense as a problem only when we say that we are trying to achieve a housing goal, *while at the same time* trying to achieve some goal in terms of the levels of aggregate output and employment. Presumably the latter goal is to be chosen with a view to finding an appropriate balance between unemployment and inflation. So that what we are discussing here is the problem of the kind of fiscal policy required to achieve some limited total GNP in any particular year, and at the same time to reserve some piece out of that total for a particular type of product. To do that you need at least two policy instruments, and those instruments are not used separately. You don't have one instrument which you use to control the total GNP, and another instrument that you use to control a volume of housing; that is obviously impossible since the housing expenditures are a part of the total GNP. That means, as Gardner said, that what we must do is select a total GNP target at any point in time and then try to find a combination of fiscal and monetary policy which will reach that total while also making it possible to have the required amount of housing.

Another way of putting this, I suppose, is that the negative of that approach consists of two kinds of wrong approaches. One is the assumption that if you do something which will in itself tend to increase the sum of public and private saving—e.g., raise taxes, lower

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government expenditures—a compensating amount of some other kind of expenditure automatically occurs. That is equivalent to saying that potential saving automatically flows into investment. It obviously doesn't. We had full employment surpluses, some of them very large, in 8 out of the last 14 years. We could not or did not find a monetary policy which made all that full employment potential saving become actual saving and actual investment. So that one fallacy is to assume that all you have to do is to provide the potential saving at full employment and that will take care of the problem. It won't. One has to have a monetary and financial mechanism to bring those potential savings into reality in the form of some particular type of investment.

The opposite approach, which is also a mistake and is one Gardner didn't mention, is to assume that if you invent some new financial devices which will stimulate a particular kind of investment, housing in this case, that thereby you are solving the housing problem. Now, if you have a given fiscal policy, it appears to many people that easier money or more financial gadgets which help to channel money into housing, will solve the housing problem. I think our experience suggests that what comes out of that may be more inflation than you want; or higher interest rates than you want; or that it will turn out that your financial program doesn't succeed in directing the resources into housing. I think it is important to deal simultaneously with the fiscal policy and with monetary policy.

If we want to select our GNP total with a view to considerations of inflation and unemployment, and then use monetary policy as one instrument to direct resources into a particular area as a part of that GNP total, we must at the same time select our fiscal policy in such a way as to leave room for the amount of housing which the monetary policy can stimulate. We have great expositional difficulty here, I think, trying to make simple statements about these matters, and almost anything anybody can say can be faulted unless he says something at great length or writes it out in a tabular form. So much for general principles.

The second part of Gardner's paper, which he dealt with very briefly, was his calculation of the amount of surplus that might be needed in order to meet the specified housing goals. I can't quibble with that calculation. I've been through that same exercise, and what one finds is that one always comes out in the same ballpark. Pushing the assumption so as to favor one side may lead you to the conclusion that what's required is a full employment surplus of a one to one-and-a-half percent order of magnitude. If you push the

assumptions all in the other direction, a little more perhaps than Gardner did in his calculations, I think you could reach the conclusion that you need a full employment deficit of a percent or so. The fact of the matter is that none of our calculations about expenditure functions, consumption functions, business fixed investment functions, inventory functions, state and local government behavior, has the degree of precision which can produce an answer right down to the last tenth of a percent. I think it's remarkable, probably suspicious, that we all managed to agree about the answers to within a percent or two, because the fundamental accuracy of our knowledge is perhaps somewhat lower than that. None the less, I think that everyone who has played this game arrives at somewhat the same conclusion.

I think the important conclusion is not that the answer under certain assumptions is that a surplus of 1.2 percent is required, and that under some other assumptions a deficit of .2 percent is required. What is important is that the range that we are talking about here is surpluses or deficits of the order of magnitude of 1 percent or so of the GNP, and also that there is a good deal of uncertainty about which side of the zero point we will come out on. This does mean that there is no basis for saying that on account of the housing program we ought to go gung-ho for big, long-term full employment surpluses. I do have one qualification to that, and it's one whose significance I can't really judge. I mentioned earlier that there are people who try to solve problems by financial gimmicks. The fact is, of course, that in these days when any congressman has a group of people who want a little service from him, he finds that the cheapest and easiest thing he can do for them is to invent a new loan program.

We have been talking about the problems of housing finance, and subsidized housing programs. There has been a great proliferation of new types of loan programs which show up someplace in the accounts, and the proliferation of loan programs may turn out to place a greater burden on our resources than we allowed for in these calculations. We don't have too much experience with them so that it is a little bit hard to judge their impact. My only qualification to Gardner's calculations is that our programs for rail transportation, local transportation, water and sewer finance, and other forms of pollution removal, and for neighborhood health centers, and other things of that sort financed through loan programs may really turn out to be very large. Then indeed a larger federal surplus may be required at full employment than these calculations allowed for. As I say, I can't give you any kind of numerical judgment on that point.

Now let me follow up then finally with what I regard as the painful implication of our inability to reach a precise conclusion on this point about whether and how much of a surplus would be required at full employment in order to achieve these housing goals, assuming that the financial mechanisms and monetary policy are there to make good on the surplus if we have it. If we don't know with any precision how much of a surplus will be required, then we can't plan in advance a long term fiscal policy. And I think that we have to admit that we don't know. What's more, Gardner has a little trouble defining a neutral monetary policy--that doesn't worry me so much, I can't define any monetary policy. I think Gardner did not address himself at all to the question of what specific monetary actions would be required to get the interest rates, and the availability of funds for all those houses. I don't intend to turn the discussion in that direction, except to note that I don't think we know the answer to that question. That means that in fact we are going to have to make a sequence of decisions as events unfold to try to see a little ahead and then move our policies to achieve our objectives as best we can.

Now, if we look at the past history in the case of housing I think what we find is that the only time that we got favorable conditions for housing is when we goofed up everything else, and managed to get into a situation where we were in a recession. Then we had plenty of room within the GNP constraint and turned on an easy monetary policy. Later we said that housing made a great contribution to the recovery and sort of used it like a first-stage rocket. It helped us to get off the ground and then we threw it away. Our problem now seems to be a similar one. Gardner suggested that he wasn't even going to bother doing this arithmetic about full-employment surpluses for the next couple of years because full employment is not what we are going to have. He suggested, if I read him rightly, and I agree that there ought to be plenty of room in the economy for all the housing that is likely to be effectively demanded in the next couple of years. Well, that's back where we were some years ago, and one hopes that we will get a substantial buildup in the volume of housing in the next couple of years. That will be good in itself, and also help in the recovery process.

Our problem then is what happens next. What Gardner said is that he can't tell us what kind of a fiscal policy to have as of 1975; probably nobody can. What we would like to have is some fairly flexible mechanism by which we could make that choice when we move a little bit closer to it, but since we can see ahead only a short

distance we have to be able to act fairly fast when we find out how much of a surplus is required, in order to take action to bring it about. We need a much more flexible kind of fiscal policy than we now have. So I do have some concern that we will be unable to predict a long-term policy in a solid way, and on the other hand unable to find the flexibility that is required in order to move the policy a little bit at a time as events unfold. So I leave you then with emphasis not on the conclusion that Gardner reached as to the magnitude of the surplus, but on the fact that there is a considerable slippage in anybody's conclusion and we have no effective mechanism as of now, I think, for making decisions which allow us to adapt to what we learn about what kind of surplus is required.



## DISCUSSION

DAVID J. OTT

As I finished Professor Ackley's paper, I tried to imagine how the argument might have been laid out if he had been discussing it with his students. Reconstructing this outline of his hypothetical lecture is fruitful in commenting on his paper.

1. We have learned that equilibrium GNP is determined by the intersection of the IS and LM curves.

2. We know one goal of public policy is to stabilize GNP at a level most consistent with our full-employment and price stability objectives. This can obviously be theoretically done with an infinite number of combinations of the IS curve (reflecting fiscal policy) and the LM curve (which reflects monetary policy), or, to put it another way, the target GNP is consistent with any level of interest rates, if the proper mix of monetary and fiscal policy is used.

3. We also know that interest rates are the dominant factor determining the volume of residential construction.

4. Now the Boston Fed wants me to discuss how fiscal policy can contribute to meeting the 1968 housing goals.

5. Since the number of housing starts implied by these goals for fiscal years 1970-78 is substantially higher than starts in recent years, this means, essentially, that we must have lower interest rates than in the near past.

6. Thus the IS and LM curves are constrained to intersect opposite the "housing goals interest rate," and the target level of GNP.

7. Unless the LM curve is vertical, which means fiscal policy only affects interest rates, *both* monetary and fiscal policy actions are

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required (and we all know that the LM curve is not vertical!). The contribution of fiscal policy, then, is to be more restrictive *by enough* to free resources to let the monetary authorities ease up so that we achieve our two goals--the specified number of housing starts and the target GNP--with the two instruments of monetary and fiscal policy. *Most important, we should not lose sight of the fact that we have two instruments--fiscal policy and monetary policy* and the fiscal policy contribution to the achievement of the housing goals can only be met in combination with the appropriate monetary policy.

To put it another way, Ackley quite properly warns us that the problems posed should be treated as but another variant of the Mundell internal-external stability policy problem, a variant which in fact produces more clear-cut conclusions as to the appropriate changes in the *direction* of policy than are possible in the Mundell case. Barring the case where the demand for money is completely interest-inelastic, the course of monetary policy is every bit as important as the course of fiscal policy in meeting the housing goals, and the clear prescription would be for a tighter budget policy coupled with an easier monetary policy. Yet when Ackley is done with his calculations, it is not at all clear that a more restrictive fiscal policy is necessary to meet full employment surplus a bit. What happened in between the theory and his empirical results?

It is possible to indicate where some of Ackley's assumptions might have led him astray. His equation for the required full employment surplus may be written as follows (in terms of requirement for Net Taxes):

$$T_n = [CCA + UCP] + \frac{[BFI + RES + (EX-IM) + INV + G - aGNP]}{1 - a}$$

where

$T_n$  = Required Net Federal taxes (NIA)

CCA = Capital Consumption allowances

UCP = Undistributed Corporate Profits

BFI = Business Fixed Investment

RES = Residential Construction required to meet 1968 goals

$(EX-IM)$  = Net Exports

INV = Inventory Investment

G = Government purchases, Federal and state-local

GNP = Current dollar potential GNP

$a$  = Personal savings rate

Now clearly the  $S_f$  estimates will be very sensitive to the assumption about the personal savings rate. For example, using Ackley's "high" estimates for BFI, RES,  $(EX-IM)$ , INV, G, and GNP, a change in the assumed savings rate from Ackley's 7.5 percent to the CEA assumption of 6.5 percent (*1970 Annual Report*, p. 81) increases the required full employment surplus (Net Taxes) by about \$11 billion in FY 1975. Judging from the recent past, Ackley has picked a relatively high savings rate; from 1960-69 the savings rate ran from 4.9 to 7.4 percent of disposable personal income and only reached 7.5 percent in 1970 II and 1970 III.

More fundamentally, I suspect that the crux of the apparent discrepancy between Ackley's theory and empirical results lies in his failure to attempt to quantify the effect of the low interest rate policy required for RES to meet the housing goals on BFI and perhaps INV. If we have learned anything from recent years, it is that monetary policy is potent, and he makes no effort to quantify the effect of the required monetary policy on private spending other than RES. If RES must be raised by 70 percent over the average of the 60's, then interest rates might have to fall by some 40 percent from their present levels, if as some works suggest, the elasticity of RES with respect to interest rates is in the neighborhood of -1.5.

Furthermore it seems to me that the really meaningful question to ask, which Ackley did not ask, would be: Given Federal purchases during FY 1975-78, how much will net taxes have to be to produce the required full employment surplus? The CEA projections of Federal purchases for calendar 1975 translate (using Ackley's deflator) into roughly \$137 billion in current dollars, some \$17 billion more than Ackley's fiscal 1976 estimate. I am led to believe he has sadly underestimated the built-in growth likely to occur in government spending, especially since the CEA estimate of Federal G was a conservative one to begin with. Furthermore given present tax law and projections of transfers, will taxes have to be raised or lowered to obtain the desired full employment surplus (or will G

have to be cut or increased)? Even if the "correct" answer is \$13 billion dollar full employment surplus, while this may be in line with past experience, the critical question revolves around whether it is obtainable with given budget and tax projections or whether tough decisions have to be made about priorities in spending or tax law changes because of the housing goals.

Finally, it occurs to me too that we might really pause and ask whether achieving the housing goals is made more difficult by present tax laws. In some work my wife and I are currently doing, we estimate that, in 1970, we gave over \$10 billion annually in subsidy to owner-occupied homes, which typically have a higher cost per unit than multifamily units. Eliminating this tax preference might make possible achieving the goals of 2.4 million housing units per year with less of a resource drain and fewer complications for stabilization policy.

In summary, the logic of Ackley's exposition supports that we need a tighter fiscal policy and easier monetary policy to simultaneously meet our housing and stabilization goals. Yet this is not borne out by his calculations because, I have argued, he takes no account of the impact of monetary policy on other types of spending, assumes an unrealistically low savings rate, and underestimates Federal spending. Finally what we most need to know is not how "reasonable" the implied full employment surplus requirement is, but how this compares with projected outlays and taxes. This, I think, is the critical question for the President's advisers, and as for now, we do not have an answer.



## DISCUSSION

ARNOLD C. HARBERGER

As I read through Professor Ackley's paper and listened to his presentation, I wondered whether you had picked the right Chicago economist. There is very little, in fact practically nothing, that I can put my finger on with which I seriously disagree. And yet, it also is true that as I independently focus on the problem, the picture that emerges is somewhat different. What one sees varies with the point of view from which one looks and though Gardner Ackley and I are observing essentially the same phenomena, we see them differently. I begin from a rather fundamentalist point of view, which I imagine is characteristic of Chicago people. Let me start out with a proposition: I don't believe that fiscal policy is designed for the fine tuning of the economy. I think that our experience with the temporary surcharge shows that if people know that an extra tax is temporary and that it is soon going off, it doesn't much affect their behavior. Nor does a temporary reduction in taxes much affect their behavior.

The permanent income hypothesis and a number of other explanations of consumption behavior all lean in the direction of saying that the reaction of people to unexpected or short-run changes in their income position is much weaker than their reaction to longer-run changes in fiscal policy. Reactions to price changes, on the other hand, are quite different. The reaction of a housewife to a permanent reduction in the price of white sheets will be smaller than the reaction of the same housewife to the January white sale. Since sheets are cheaper only so long as you buy them in January, the response to a short-term price reduction will be larger than that stemming from a permanent reduction of the same magnitude in the price of sheets.

Monetary policy is like that. When interest rates go down in a fashion which is not regarded to be permanent, you get people to enter the market as borrowers in order to take advantage of the bargain price of credit. When interest rates go up in a way that is not regarded to be permanent, people hold off the market in a way that

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they would not do if those higher interest rates were to prevail forever. So, you get a lot of bang out of fine tuning the economy by way of monetary policy--an amount of bang that I do not think can be duplicated readily by temporary movements in fiscal policy. As a consequence I think that the proper way of operating the economy--not just proper, but even almost necessary--is to set fiscal policy with regard to relatively longer term considerations, and to leave to the monetary authority the job of helping us attain our particular policy goals in the shorter run. This is my first major point.

If one accepts that position, there is a consequence that almost inevitably follows. That is that historically the construction industry has been what I call the handmaiden of monetary policy. When monetary policy is tight, the construction industry is squeezed. The purpose of tight monetary policy is to free resources some--to reduce the total demand for resources, if you like--and that squeeze takes place largely by pushing resources out of the construction industry. And, when monetary policy is easy, somehow the resources crawl out of the woodwork to allow housing starts to go up by three or four hundred thousand, as between a tight and an easy period.

Now, because the housing industry has acted as a sponge, absorbing resources when money is easy and releasing them when it is tight, I have always been very skeptical of the idea, very worried about the idea, that our government should have a set of housing goals which would try to get a given number of housing starts per year and keep housing on a certain preset track. That is, in my view, the easiest conceivable way of emasculating monetary policy.

Now, I don't want to say that having a set of housing goals of 26 million over a decade requires that one must try to keep housing on a particular track through time, but I am disturbed that so much of the discussion that I've heard over the last couple of years on this question reflects a preoccupation that our tight monetary policy has hurt housing. I'm not worried by this. Quite to the contrary, I think that I'd be worried if housing were not being squeezed, because then the tight monetary policy would not be having its desired effect. I think that in the other areas in which monetary policy can affect real spending it is much less powerful than it is in housing, and we have got to continue to allow tight monetary policy to squeeze housing, and easy monetary policy to stimulate housing, if we are going to have an effective fine-tuning or short-run stabilizing policy tool in our kit.

In this sort of framework I think that you can see that *ceteris paribus*, if monetary policy is going to attempt to reach full employment, the tighter is fiscal policy, the easier will monetary policy have to be. Likewise the easier is fiscal policy, the tighter will monetary policy have to be in order to prevent unwanted inflation. And broadly speaking, here I am sort of restating the quotation that Gardner Ackley cited and proceeded to disagree with. Well, I'm putting the same idea in a framework where I think it is not so easy to disagree. Professor Ackley's summary position was that one should make monetary policy as easy as one can, and then find out what fiscal policy meshes in with that to produce full employment, etc. I have no theoretical quarrel with that; I have a practical quarrel in the sense that I cannot see fiscal policy in the residual role--i.e. the fine tuning role. In my opinion it's a question of priorities or possibilities rather than any question of fundamental theoretical disagreement--and I see fiscal policy as the primary set of tools for long-term policy, and monetary policy as the residual regulator of the economy against short-term fluctuations.

Now let me turn to the current problem. I think that Professor Ackley made an interesting point in saying that really between here and the next couple of years, full employment isn't in the cards anyway, and therefore there should be ample resources available to meet our housing goals and others as well. Again, while in a sense agreeing with the statement I look at the problem from a different viewpoint. The way I see it is as follows. Our federal policy aims at a targeted reduction in the rate of inflation. The policy is to gradually squeeze out the expectations of continued inflation that have been built into the economy. But in order to reduce the rate of inflation you can't give people what they expect. You have to give them less inflation than they expect, or else they will keep on expecting inflation as before. In order to give people less inflation than they expect the economy must operate with some abnormal slack. You can't push down the rate of inflation and keep full-tilt full employment.

So, as I interpret our policy, as I read the report of the Council, as I listen to policymakers talk, I think that the aim is to have a targeted rate of unemployment which is slightly above the normal level--perhaps on the order of 5 percent or so instead of a "normal" 4. But a targeted rate of unemployment which is somewhat above 4 percent for a time (until the inflationary expectations get wrung out) implies a targeted path of GNP that is lower than the full-employment path. If things were all rosy, the targeted path of

GNP would be the full employment path. But when we are trying to defuse inflationary expectations, the targeted path of GNP has to be somewhat below, even though perhaps not much below, the full-employment path. Once this is granted, it once again becomes true that if an easier fiscal policy must be accompanied by a tighter monetary policy in order to stay on that targeted path, and a tight fiscal policy must be accompanied by an easier monetary policy to keep the economy on that path. So, taking Professor Ackley's quotation as my point of departure, I come back to something like the traditional trade-off between monetary and fiscal policies.

Finally, the question arises as to what our aims should be. Here let me put on my public finance hat and say that I am extremely disturbed and distressed by the 26-million-unit housing goal. To me the tax treatment of housing is one of the greatest scandals of our federal revenue system. By failing to tax imputed rent on owner-occupied housing, we provide implicitly a 70 percent subsidy to Governor Rockefeller's several dwellings. We provide a 20 percent rent subsidy to the average assistant professor, and we provide zero rent subsidy to all of the people who are living at poverty levels, and are subject to zero marginal rates of income tax. There may be some people who don't think that this is scandalous, but I do. Moreover, it is well known that, as far as its incidence across income brackets is concerned, housing is a luxury good, in the sense that over a substantial range at least the fraction of income spent on housing, and particularly on owner-occupied housing, rises with income level.

So, I am much in favor of housing policies aimed at trying either to equalize the incentive to housing, or perhaps to give special housing incentives to those at the poorest end of the scale--but I certainly see no reason to provide any special incentive to owner-occupied housing for people who have adequate levels of living, let alone an incentive that gives proportionately more benefit to the rich than to the poor. So, I suspect that if we were to adopt a housing policy which was at all rational in economic terms, which tried to get away from the mess that we are currently in as far as tax laws are concerned, we would end up with far less than 26 million housing starts over the next decade. And I think that such a policy would also be consistent with substantial growth in our housing stock, even though not as much as is now projected. Certainly subsidized housing can be provided for the very poor. I certainly suspect that if I were to start writing the laws or advising on the matter, this is a direction in which I would go.

Perhaps this is in the idealistic tradition of Chicago. Henry Simons



used to write and make speeches about all the ways in which our society was messing itself up, and how it could all be improved, and in his case the things that he talked about were fairly obvious and straightforward, and his conclusions were equally--what shall we say--visionary and utopian as mine. I don't want any of you to think that I really believe that it is politically likely that we are going to turn about 180 degrees in our tax treatment of housing, but I do feel that an honest and clear economic appraisal of the system that we have would reveal tremendous deficiencies, which have the effect of having far too much housing--particularly in the middle and higher income brackets. In my own view there is no sound economic or other justification for this kind of treatment.

## *Regulation Q: The Money Markets and Housing—I*

ALLAN H. MELTZER

The critic of controls who is persuaded that one control begets another certainly finds supporting evidence in the history of regulation of deposit rates. Although many years passed before increased market rates and the prohibition of interest payment on demand deposits induced a sufficiently large substitution of time for demand deposits to make the original Regulation Q rates into a binding constraint, not many additional years later we find a new and very complex set of controls on both the assets and liabilities of banks and non-bank financial institutions. Supplementing the direct control of commercial bank demand and time deposit interest rates, there is now a regulated spectrum of rates for liabilities classified by age, maturity, and type of institution and a companion set of reserve requirement ratios and borrowing arrangements that would take more than my allotted time to describe fully. That the present regulations are not regarded as satisfactory to those who believe regulations are useful quickly becomes clear to any reader of the financial press. Proposals for selective controls on assets compete for space with expressions of concern about the unregulated Euro-dollar market and explanations of new or substitute regulations.

There is not much that needs to be said about the subject of this session, Regulation Q ceilings on interest rates paid to small savers. It is easy to point out that the regulations cannot be defended on grounds of equity, but doing so comes close to tilting with a windmill, since I don't know anyone who argues the contrary case. The usual argument for ceilings is that because small savers are less responsive to changes in interest rates, the government can "protect"