

## Another Shocking Reversal in Macroeconomics

“The potency of fiscal policy—both good and bad—has been demonstrated time and again in the past couple of decades.”

—Walter Heller, 1968<sup>1</sup>

**W**ho wrote this? “Fiscal policy is no longer a major tool of stabilization policy in the United States. Over the foreseeable future, stabilization policy will be performed by Federal Reserve monetary policy.”

Milton Friedman? No, it was not a monetarist.

I recently met with Milton Friedman in his home in San Francisco, and asked him who he thought wrote the above statement. “Alan Greenspan?” he queried. No, it wasn’t a Federal Reserve official.

The author is none other than Paul Samuelson! In his latest (15th) edition of *Economics*, co-authored by William D. Nordhaus, the premier Keynesian economist admits defeat for fiscal policy as an effective countercyclical tool.<sup>2</sup> This is truly an amazing confession, a shocking reversal of his long-standing bias of yesteryear.

It was Samuelson who wrote in his first edition (1948) of his famous textbook, “Today few economists regard Federal Reserve monetary policy as a panacea for controlling

the business cycle.” (1st ed., p. 353) Only fiscal policy mattered. His pivotal chapter, “Fiscal Policy and Full Employment Without Inflation,” totally ignored the role of money in the economy.

By the ninth edition (1973), his views had shifted to a middle ground. After labeling monetarism “an extreme view,” he declared, “both fiscal and monetary policies matter much.” (9th ed., p. 329) However, Samuelson stood squarely in the fiscal camp. The title of his chapter, “Fiscal Policy and Full Employment Without Inflation,” remained the same from the first edition until the eleventh edition (1980), the last written solely by Samuelson.

Finally, in the latest edition (1995), Samuelson has thrown in the towel, as if to admit, “We are all monetarists now.” According to the MIT professor, running a federal deficit to jump start the economy “has lost much of its attractiveness to policymakers and macroeconomists.” (15th ed., p. 644) His concluding chapter on government economic policy is now entitled, “Policies for Growth and Stability.”

### Why Fiscal Policy Has Become Impotent

In the late 1960s, economists debated the merits of fiscal policy (spending and tax changes) vs. monetary policy (the money supply and interest rates). The Keynesians argued that fiscal policy was the most pow-

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erful tool, the monetarists defended monetary policy as the most influential.

Now the debate is over: the monetarists have won.

Under the influence of new theories in economics (especially public choice and rational expectations), Samuelson offers several reasons for an impotent fiscal policy today: increasing delays (a year or more) between changes in the economy and Congressional action on the budget; ineffectiveness of deficits or tax cuts to stimulate consumer spending; and the enormity of the national debt, which severely limits the ability of lawmakers to run higher deficits to fight recession. In sum, declares Samuelson, fiscal policy has become "useless." (15th ed., p. 644)

## Artificial Stimulants Don't Work

Samuelson's amazing change of heart reflects a growing realism in the economics profession. It never did make sense to artificially stimulate the economy through makework projects, war production, and other spendthrift programs, as Keynes suggested. But running a deliberate deficit is not only "useless," it is harmful to the economy. It discourages private saving and forces lawmakers to raise taxes in the future. Indeed, that has been the trend: higher deficits and higher taxes.

The lesson is clear: government needs to move in the opposite direction if it truly wants to stabilize the economy and permanently increase economic growth. By cutting out wasteful spending, it can turn the deficit into a surplus, and reduce taxes sharply.

## Monetary Policy Is Useless, Too

Paul Samuelson needs to learn another lesson: Efforts to stimulate the economy through "easy money" Federal Reserve

monetary policy are useless, too. If the Fed artificially lowers interest rates and expands the money supply, it can only cause an unsustainable boom-bust cycle. History has demonstrated this "Austrian" insight time and time again. Easy credit may provide temporary recovery, but the long-term effects are serious—more unemployment and recession in the future. In short, there is no free lunch. Active government intervention in the macroeconomy, whether in the form of deficit spending or easy money, is harmful to long-term growth.

## Returning to the Classical Model

The best policy is non-interventionism. Taxes should stay low. Government budgets should be limited to essential services, and regularly balanced. The money supply should be stable and non-inflationary. Interest rates should not be manipulated.

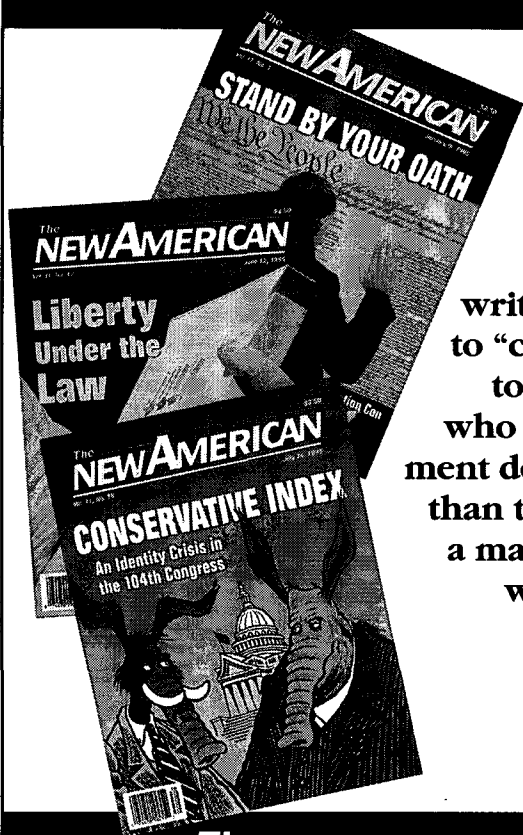
There is nothing new about this non-interventionist approach. It represents the old classical school of Adam Smith (balanced budgets, low taxes, sound money, laissez faire).

What is noteworthy is the economics profession's gradual shift away from Keynesian economics toward the classical position. An examination of Samuelson's 15 editions of *Economics* reveals that he has slowly but surely abandoned the tenets of Keynesianism. In the past, he favored deficit spending; now he's opposed to it. He denigrated savings; now he promotes it. He condoned central planning; now he supports market reforms. Might we see a total conversion to laissez faire by the next edition, due to be released on the 50th anniversary of his first edition? We can only hope. □

1. Walter W. Heller, "Is Monetary Policy Being Over-sold?" in *Monetary Policy vs. Fiscal Policy*, by Milton Friedman and Walter W. Heller (New York: Norton, 1969), p. 31.

2. Paul A. Samuelson and William D. Nordhaus, *Economics*, 15th ed. (New York: McGraw-Hill, 1995), p. 644–45.

# Tired of *Time* and *Newsweek*?



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# BOOKS

## The Freedom Revolution

by Dick Armeý

Regnery Publishing • 1995 • 329 pages • \$24.95

Reviewed by William H. Peterson

What lifts this book above the pack is extensive use of Armeý's Axioms—witty though incisive truisms on public policy, from a man in a position to know. The author is the House Majority Leader, an architect of the "Contract with America," a champion of the flat tax, and a former economics professor at the University of North Texas.

Case in point is U.S. farm policy. The apt Armeý Axiom here: "One bad government program creates the need for a worse one." The U.S. Agriculture Department starts out by benevolently guaranteeing the farmer "client" ample price supports on his crops and thus a high return on his investment. The unsurprising upshot is overproduction or vast farm surpluses that become unmanageable, that cram government storage bins.

This leads to an even more bizarre consequence. The bureaucrats then pay farmers not to farm. Literally. And the amount of land taken out of production is prodigious. In a typical year, reports Representative Armeý, Uncle Sam idles 60 million acres, an amount equal to the entire land area of Ohio, Indiana, and half of Illinois combined.

The above Armeý Axiom also helps explain the bizarreness of America's mass transit system. Over the last 25 years, Uncle Sam has pumped in more than \$100 billion in mass transit subsidies, and now accounts for two-thirds of the operating cost of mass transit. With fewer skills than the average U.S. worker, the average transit worker is still paid 70 percent more. Yet ridership sinks and is lower today than in the 1960s. Nothing succeeds like a failed government program (a Peterson maxim).

Other targets of Armeý Axioms include the Small Business Administration (with a

20 percent default rate on SBA loans), U.S. job training programs (the Job Corps program nips taxpayers for \$30,000 per trainee), Rural Electrification Administration (its mission was over in the 1950s but it keeps on draining taxpayers), Legal Services Corporation (its tax-financed lawyers sue state and local governments on behalf of violent criminals evicted from public housing), and so forth.

More Armeý Axioms: "The politics of greed always comes wrapped in the language of love." "When you're weaned from the milk of sacred cows, you're bound to get heartburn." "If you love peace more than freedom, you lose." "Social responsibility is a euphemism for personal irresponsibility." "There is nothing more arrogant than a self-righteous income redistributor."

Freedom works, says Dick Armeý. That's his working title of this cutting yet beaming book. He holds America has only begun to grasp the meaning of great events in recent years—the revolution that sank Eurocommunism, for example, or the computer revolution, or the free-market revolution. These are but steps in the larger Freedom Revolution.

At the heart of this drama is Congressman Armeý's simple idea that people should be trusted to spend their own earnings and decide their own futures. The most just and compassionate societies, he says, are also the most free. What welcome heresy! □

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## Bioethics—Opportunities, Risks, and Ethics: The Privatization of Cancer Research

by Robert K. Oldham, M.D.

Franklin, Tennessee: Media America, Inc. • 1995 • 416 pages • \$14.95 paperback

Reviewed by Jeffrey A. Singer

Bioethics burst onto the scene last decade. Its mission: to analyze and judge the moral aspects of clinical and research