There are many salubrious guides we acquire from the code of the gentleman in Shirley Letwin's fascinating book. She has mined Trollope with scrupulous but generous disposition. Our Victorian forefathers, Liberal and Tory alike, were far from unmindful of the relation that must exist between government and morality. Most of them thought, however, as did the Framers of the American constitution, that virtue is overwhelmingly within the domain of family, church, and community, and that while a great statesman such as Washington and Lincoln can occasionally raise the level of morality in the nation, this comes not from conscious pursuit of virtue but from skillful steering of the ship of state.

Robert Nisbet

Reaganomics Before and After

TOMORROW, CAPITALISM. *By Henri Lepage*. (Open Court, LaSalle and London, 1982) $14.95.
TAX REVOLT. *By Alvin Rabuska and Pauline Ryan*. (Hoover Institution, Stanford, California, 1982) $16.95.
GREED IS NOT ENOUGH. *By Robert Lekachman*. (Pantheon, New York, 1982) $13.50.
HOW TO END THE MONETARIST CONTROVERSY. A JOURNALIST'S REFLECTIONS ON OUTPUT, JOBS, PRICES, AND MONEY. *By Samuel Brittan*. (Institute for Economic Affairs, London, 1982) $1.50.

While browsing through the London School of Economics bookshop one day in 1976, I was struck by the number of recently published books and monographs which appeared to blame Britain's economic problems on excessive taxation, regulation, and public sector mismanagement generally. It seemed from the titles on the bookshelf that, during my two years' absence from Britain, there had been a dramatic change in both academic and popular thinking about economic issues. With the advantage of hindsight, it is now easy to view those books and monographs as precursors of the intellectual and attitudinal changes which would subsequently help to elect a new and radical Conservative Government under Margaret Thatcher in 1979.

If some future historian ever searches for similar background material with which to understand the conservative swing in American politics that became apparent during the late 1970s and culminated in Ronald Reagan's 1980 election victory, he will find it in *Tomorrow, Capitalism* by Henri Lepage and *Tax Revolt* by Alvin Rabuska and Pauline Ryan.

Henri Lepage is a French journalist who came to the United States during the mid-1970s in order to investigate what he calls "the new economics." *Tomorrow, Capitalism*, which was originally published in

France during 1978, is a summary of what he found. The range of political and economic thinking which he reviews is remarkably extensive. It includes the theory of human capital, the economic theory of property rights, the new economic history, the theory of public choice, monetarism, and libertarianism.

Despite the broad scope of the book, however, Mr. Lepage missed some very important people, such as Dr. Martin Feldstein (a pioneer in the analysis of social security and its impact on saving), Dr. Robert Lucas (rational expectations theory), and even Dr. Robert Mundell and Dr. Arthur Laffer. There is no mention of supply-side economics, at least no mention of the term, and the chapter on monetarism failed to anticipate any of the subsequent disagreements about fixed exchange rates, measurement of the money supply, or the gold standard. These omissions notwithstanding, the Lepage book is still a useful and very readable layman's guide to many aspects of American economic thinking on the right, especially in microeconomics, before it became fully fashionable at the end of the 1970s. Mr. Lepage brings together a great deal of material in support of his argument that "we are silently experiencing the birth of the new economic libertarianism of tomorrow, based on a rigorous general theory of capitalism."

Mr. Lepage devotes the first third of the book to analyzing several controversial issues in economic history. Was the English Industrial Revolution beneficial to the working class? How important was the railroad to American economic growth in the 19th century? Were the antitrust laws necessary to maintain competitive markets in the U.S.? Why did feudalism decline? How did private ownership of agricultural land evolve in England from the system of common land ownership which prevailed before the wool boom of the 18th century? He reopens the debate on each of these questions in order to demolish what he perceives to be dangerous and misleading myths about the economic history of the United States and Britain, and especially to "undermine the comfortable historical commonplace that traces all improvements to the government and evils to the marketplace." Complementing his rebuttal of much left wing criticism of the market economy's role in Western history is a strong emphasis on the overwhelming importance of private property to successful economic performance. He argues that:

> ...the appearance of economic growth in Europe was no historical accident linked to a sudden technological revolution in the eighteenth century. Early modern Europe probably did not count among its inhabitants more investors, innovators, or men of genius than eleventh century Europe or the Chinese empire at its apogee. What distinguished it from other periods of history, and from other great civilizations that preceded it, was the peculiar system of property rights, which made innovative activity more profitable than anywhere else and ever before. Because of the drop in costs and the increase in the possibility of gains, more individuals began taking risks that had been too expensive for their ancestors. It was not people, but their institutional environment, that had changed.

With this historical foundation laid, the author proceeds to examine recent American theories about the growth of the state, and the challenges which modern government poses to economic freedom. The dominant influence in these chapters is the "public choice school," as outlined in the works of James Buchanan and Gordon Tullock. Mr. Lepage is excited about public choice theory, because it distinguishes between an optimum and suboptimum role for government rather than automatically rejecting a role for government altogether. As he carefully explains,

> Public choice has no wish to dismiss government intervention out of hand; it seeks (instead) to make people aware that the state is a no less imperfect mechanism for allocating resources than the market. It wants to apply to the state and the public sector the same techniques that have been used for three decades to register the defects of the market economy. Public choice economists suggest not that we lapse into the Manichean view—still prevalent in some conservative circles—that denounces the 'vicious' state and extols the 'virtuous' market but that the government intervene only where it is evident that the market solution really is more costly to society than public intervention. The objective of public choice is, in a sense, to reverse the burden of proof; instead of starting from the principle that any intervention is legitimate as soon as market imperfections are recorded, they want to be sure that the imperfections of government mechanisms are not greater than the market imperfections we want to remedy.

Having defined his theory of what constitutes optimum government, Mr. Lepage goes on the attack, surveying the deficiencies of government intervention in a wide range of policy areas: transportation regulation, professional licensing, social welfare spending, land use planning, environmental protection, education, and so on. He concludes this section of the book with a fascinating chapter on Gary Becker (who remains practically unknown outside of academic circles) and his human capital theory. Professor Becker's work deserves special attention, in his opinion, because it provides a rigorous microeconomic explanation for all aspects of human behavior and social organization. It thus provides a framework for implementing the optimal government philosophy of the "public choice school."

From the perspective of 1982, one of the most striking things about the final chapters of *Tomorrow* (monetarism aside) is the extent to which some of the author's most basic themes are now widely accepted in the United States. Government deregulation of the transportation, energy, and financial industries began under a Democratic administration at about the time Mr. Lepage's book first appeared in France. Economic ideas which were identified primarily with the University of Chicago ten or twenty years ago now have a wide following in academic institutions all over the United States. Organizations such as the Heritage Foundation and American Enterprise Institute now publish dozens of monographs a year about the costs of inefficient regulation to particular industries, the consumer, and the economy generally.

In fact, what would probably most surprise a European on a return visit to the U.S. today is the extent to which this change has occurred without any sharp ideological debate about the role of government or a dramatic polarization of the society between left and right. An intense philosophical debate about the role of government has been occurring in the U.S. to be sure, but much of the momentum for deregulation and more rigorous microeconomic analysis of government intervention has resulted from a practical desire for efficiency and cost effectiveness rather than a rereading of political philosophy. The counter revolution of recent years has been led as much by M.B.A.s and econometricians armed with computers as by people with an understanding of the decline of feudalism or public choice theory. As James Buchanan himself notes in the introduction to *Tomorrow*, "Modern economics, as a discipline in the (American) academy has almost totally failed in its didactic role." The Reagan revolution is adding a great deal of ideological zest to the movement towards deregulation and more "optimum government." But when historians look back on the current period in twenty years' time, they may wonder if the most durable elements of the Reagan revolution were not bound to happen anyway because of the intellectual currents already stirring beneath the surface when Henri Lepage came to the United States in 1976.

While *Tomorrow* provides a far-reaching exposure to many of the intellectual trends which preceded the Reagan election victory of 1980, *Tax Revolt* examines a grass roots movement to translate public resentment about the growth of government spending into a practical political program. The book provides a detailed history of the California tax reduction movement which culminated in Proposition 13. It is very thorough, almost too thorough for someone without a strong interest in California politics; but for that reason it is a good case study of the political process at work. It also provides some fascinating background material on the biggest spender in postwar California politics, Governor Ronald Reagan.

Although four years have passed since Proposition 13 was first approved, it is still not possible to make a complete assessment of its effects. Alvin Rabuska and Pauline Ryan explain well what the tax revolt did *not* do, such as fulfilling opponents' charges that it would destroy essential public services, or cause a recession, but more time and research will be needed to understand its full consequences. The book argues, for example, that Proposition 13 contributed to a dramatic upsurge in employment and economic growth, but the authors then fail to examine where the employment growth occurred and what might have happened in the absence of Proposition 13. A counter factual economic history study of the type reviewed in the Lepage book would have been most useful.

It makes intuitive sense to argue that tax reduction is beneficial for a state's economic growth. But the process by which it promotes growth is still not fully understood. This case study of California, so thorough in many other respects, adds little to this debate, except to restate old assertions and cite a few macroeconomic statistics. Indeed, there is a remarkable paucity of material about how state and local tax rates around the nation compare and what impact they have on economic performance. Why has Minnesota, with the highest marginal tax rates in the country, spawned so many successful entrepreneurs and new corporations in the past three decades, while other midwestern states with much lighter tax burdens stagnated? Why did the low tax rates prevalent in the southern states for many decades prior to the 1970s do so little to encourage economic growth until recently? *Tax Revolt* does not answer these questions.

But while the economic discussion is incomplete, the political side of *Tax Revolt* is fascinating, especially when one ponders its implications for the Reagan administration. Proposition 13 attracted widespread public support because of a perception that it would benefit everyone, landowner or renter, in a material way. A subsequent referendum to reduce the income tax burden was unsuccessful partly because many people believed that it would favor the rich more than middle-income or low-income people. The Reagan tax program makes economic sense, from the vantage point of encouraging savings and incentives because it provides everyone, rich or poor, with a proportional income tax cut aimed at reversing the inflation-induced bracket creep of the late 1970s. But the experience of Proposition 13 suggests that the president may derive far less benefit from his tax program than it deserves, because the rich will clearly get more dollars back from it than the middle income or poor.

Professors Rabuska and Ryan also raise an important question about how much the voters really *wanted* to cut public spending during the late 1970s. They supported Proposition 13, knowing that there was a large state surplus to absorb the revenue loss, but rejected income tax cuts two years later, partly because they would help the rich but also because the state surplus was gone. Opponents were then able to argue more persuasively that big service reductions would surely follow. Was Proposition 13, one wonders, a referendum to slash public spending? Or a referendum to spend the state surplus on lower property taxes? The polls suggest both factors played a part.

Whatever the final answer, the authors conclude that Proposition 13 was more effective at slowing spending growth than a later proposition (number 4) which mandated slower spending growth but did nothing to reduce public revenue. This, too, has important implications for the Reagan economic program. While there is fierce debate about the supply-side consequences of tax cuts, there is remarkable agreement that they will at least force Congress to restrain spending by denying it new revenue. President Carter might have balanced the budget by 1983 simply because of the revenue growth produced by inflation. In fact, the new movement for a constitutional amendment to balance the federal budget may be a godsend to liberal Democrats because it could conceivably give them the authority to enact tax increases which would guarantee a permanent and uninterrupted flow of money into new spending programs.

An issue which Professors Rabuska and Ryan might have explored further in a California context is the breakdown during the past decade between public expenditures for current services and capital projects. If the tax revolt movement had not been slowed by the recent recession (which is finally forcing California to cut spending), it almost certainly would have run into problems at some point because of an issue which now seems to rate a headline a month in the nation's media: the decay of the country's public infrastructure. If we are to believe these press reports, the country will have to spend billions of dollars repairing highways, bridges, and sewers during the next decade, because during the 1960s and 1970s, politicians tried to pay for rapid growth in social service expenditures by cutting back on infrastructure maintenance and improvement. While the quantity of public spending grew rapidly in the past two decades, its quality deteriorated. There was too much consumption, too little investment.

The first generation of tax revolt leaders, like the Reagan administration in 1981, had a field day campaigning for tax cuts. The next generation will have to grapple with the much more difficult task of setting actual priorities for public spending and asking the people to accept them. Here the risk is that infrastructure improvement in the 1980s will produce new taxes which will then be diverted back to social expenditure programs in the 1990s. We may need not only a continuing tax revolt, but a revolution in the way we account for public expenditures to get effective control of state and local government spending.

After Ronald Reagan's landslide election victory, most liberal Democrats decided to keep quiet and give the president twelve to eighteen months to demonstrate that his program either could not work, or did so at such a high cost that it was intolerable. Not so with Robert Lekachman. Almost immediately after the Reagan inauguration, he went to work writing *Reaganomics, Greed Is Not Enough*.

The book is ostensibly about the Reagan program. But the discussion of Reaganomics is simply the focal point for a strident polemical denunciation of capitalism, corporations, the Pentagon, and anyone with an income above the median. Indeed, the flavor of the book is quickly apparent from the chapter headings in the table of contents: Taxes, the Falwell Fix (about supply-side economics), Fill It to the Rim with Grim (about budget policy), and Corporate Lib (about regulatory policy).

There is doubtless plenty to criticize in the Reagan program, but Professor Lekachman rapidly disqualifies himself as a credible analyst. In the chapter on tax policy, for example, he says:

> It is permissible to be skeptical about extravagant claims for the incentive impact of lower marginal tax rates on a second ground, embarrassing to supply side enthusiasts if they did not generally ignore it. Broadly speaking, taxes on capital gains, large incomes, and corporate profits have been steadily declining for a dozen years. For practical purposes, Congress has been quietly phasing out the corporate profits tax as a revenue source... Why, it might legitimately be asked, haven't these amply rewarded managers and investors already unleashed the investment boom needed to renew economic growth and make America great?

In actual fact, real tax rates on both individuals and corporations have been rising steadily during the past decade because of the interaction of inflation with a progressive income tax code and corporate cost accounting systems based on historic values rather than current cost. There is not a single financial instrument denominated in U.S. dollars which paid a positive real after-tax return to people in high income tax brackets during the 1970s. Professor Lekachman seems to think that bracket creep was exclusively a problem for low-income people, but *all* income tax cuts between 1963 and 1978 were skewed entirely towards taxpayers earning under $20,000.

The chapter on monetarism starts out intelligently, but then shifts to outrageous assertions about what monetarism really means. First, it is alleged to be supported by bankers who want to increase their profits, then a conspiracy to impoverish the economies of states which elect liberals to Congress.

> For American politics, persistence in monetarism carries an ominous implication. The energy barons and the defence contractors have traditionally financed the Far Right. The relatively civilized capitalists of the Northeast have frequently supported moderate Republicans. Political power follows the flow of wealth. The monetarist threat is, if possible, more serious as a political than an economic phenomenon. A tidal wave of funds for reactionaries might swamp not merely the remaining handful of congressional liberals, but also old-fashioned conservatives with lingering affections for civil liberties and civil rights and a frugal version of the welfare state.

The reality, of course, is quite different. First, high interest rates have destroyed the profitability of many financial institutions, especially those specializing in long-term, fixed rate lending, while greatly adding to the deposit cost management problems of all others. Secondly, it was precisely the easy money policies of the 1960s and 1970s, so beloved by Professor Lekachman, that helped to spawn the energy and real estate inflation which produced so many of the new Republican "sunbelt fortunes."

Indeed, the biggest casualty so far of the Federal Reserve Bank's (Fed) tight money policies has been an Oklahoma bank, which specialized in energy lending, and whose failure has cut off financing to hundreds of small or medium-sized energy entrepreneurs, probably most of them enthusiastic supporters of Ronald Reagan. The sunbelt states were destined to enjoy greater prosperity in the 1970s, but easy credit greatly speeded up their growth process. The adjustment to monetarist economic policies will be most difficult for those who expected inflation and rapid growth to cover up all of their mistakes. In the first half of the 1980s, energy promoters and real estate speculators will top the list of casualties.

Intelligent writers on the left are now pondering the causes of economic decline in the 1970s and what they imply for the future of social democracy and the welfare state. Not so with Professor Lekachman. His scapegoat for the 1970s was Jimmy Carter, a southern conservative masquerading as a populist do-gooder. Not once does he seriously explore such problems as the demographic pressure on the social security financing system, the role of trade unions in creating structural unemployment, or the efficiency of wage/price controls in an economy straining to expand. In his book, there are only good guys and bad guys. The good guys are always the government, left wing trade union leaders, and businessmen who want a strong interventionist government, such as Felix Rohatyn. (One wonders what Professor Lekachman would have done with John Connally style corporatism.)

One writer who should produce a good critique of the Reagan economic program is Samuel Brittan, whose 1981 monograph, *How to End the Monetarist Controversy, a Journalist's Reflections on Output, Jobs, Prices, and Money*, reappeared in updated form this spring. Mr.

Brittan is a regular contributor to the *Financial Times* op-ed page and probably one of the two or three best economic journalists in the English-speaking world today. In fact, he has no exact counterpart in the American press. The U.S. press is very good when it comes to business reporting, but it is very deficient in the area of economic journalism unless one broadens the definition to include Wall Street newsletter writers. In fact, one of the subtler ironies of the current period is that the quality of economic journalism often seems to vary inversely with a country's economic performance. As inadequate as American economic journalism may seem today, it is still vastly superior to that which existed twenty years ago, when the country was far more prosperous.

British economic journalism often fascinates Americans these days, because they have been where we appear to be going. While new social fads may start in California, the economic decline of the West started first in Britain and so British journalists frequently tend to have valuable insights on what may happen next in the United States. Indeed, during 1978 and 1979, there was only a handful of American economists who came close to rivaling the accuracy of *Financial Times* columnists, such as Samuel Brittan, in diagnosing the problems of the American economy and predicting where they would lead. His little book is especially valuable because it contains a sober, dispassionate analysis of monetarism from someone who embraced it very early and thus has had considerable time to reflect upon its uses and abuses. It is impossible to overstate the relevance of such a discussion to the United States, because the Reagan economic program was founded on perceptions about the conduct of monetary policy, which were seriously flawed and inconsistent with many of the objectives of fiscal policy.

There are four major themes in the Mr. Brittan's book: First, that the goal of monetary policy is to contribute to price stability and, to a lesser extent employment stability, by keeping total spending (money GDP) on a steady path without large fluctuations up and down. Secondly, that attempts to guide monetary policy by focusing solely on narrow measures of the money stock are based on the fallacious premises that the demand for money comes mainly from its own citizens and is stable over time. Thirdly, that there is a minimum underlying rate of unemployment, which is consistent with price stability, and that it cannot be reduced by trying to increase the level of total nominal spending in the economy without generating worse inflation. And, finally, that if the noninflationary rate of unemployment is unacceptably high, the only way to reduce it consistent with lower inflation is by enacting supply-side policy changes which correct structural rigidities and inefficiencies to the markets for labor (reduce trade union power), housing (eliminate rent controls or public housing rules that retard labor mobility), and other resources (eliminate taxes which discourage saving).

It is a pity this book was not around eighteen months ago because a quick perusal of the summary would have exposed some of the contradictions in the Reagan program. First, the initial Reagan budget strategy, as outlined in early 1981, was based on the assumption that nominal GNP would expand by 12–13 percent while the Fed's money growth targets were consistent with only 8–9 percent nominal GNP growth. When outsiders questioned administration economists about this apparent contradition, they were told that supply-side would produce a surprise surge in velocity, making the money targets consistent with a higher level of nominal GNP growth. If velocity were to be so accommodating, of course, the logical question to ask is: Why have money targets in the first place?

Secondly, when it became apparent that the budget deficit would increase dramatically after the tax cuts, administration spokesmen denied that this would pose any challenge to monetary policy. The government, they said, would merely borrow back the tax cuts while still leaving the economy with the incentive effects of lower tax rates. On the surface, this answer struck many as simple and reasonable. But a massive increase in borrowing by the government still had to be cleared by the financial markets at a price which reflected some of the risk that the Fed might not be able to avoid monetizing a large budget deficit forever. During the past two decades, total private sector borrowing in the American economy has tended to average about 12–13 percent of GNP with numbers as low as 8-9 percent in periods of recession and numbers as high as 17–18 percent during periods of accommodative monetary policy and rapid economic growth such as 1976–1978.

If the total level of borrowing as a share of GNP is to be held in a traditional noninflationary range while government borrowing shoots up to 4–5 percent of GNP, the private sector has to be crowded out unless the savings rate can be sharply increased through a change in the tax rate. Given the modest nature of the Reagan tax changes, when adjusted for inflation, there was little reason to expect that they would suddenly revolutionize saving behavior and allow the government to sharply increase its borrowing without creating friction in the financial markets.

Since the Fed was committed to monetary targeting before the election of the Reagan administration, one could argue that a recession would have happened in 1981 and 1982 regardless of who was president. The inertial rate of inflation still present in the U.S. economy during early 1981 was about 8-9 percent and thus too high for any real economic growth so long as the Fed adhered to money growth targets consistent with only 8–9 percent nominal GNP growth. In a monetarist world, the budget deficit affects the mix and not the level of economic growth. But the Reagan administration worsened the distributional problems of adjustment to monetarism and disinflation by introducing a fiscal policy which added to the crowding out pressures on credit sensitive industries, such as housing, autos, and capital spending. Exports suffered, too, because of the impact of high interest rates on the dollar.

If the resulting economic crisis were not so serious, the irony of the situation would be highly amusing. A financial community which greeted the Reagan election victory in 1980 as the start of a crusade for private sector revitalization will now devote most of its energy to funding the government deficit. In order to contain the size of the deficit as the economy deteriorates, the administration is now committed to increasing taxes on business and repealing some of last year's investment tax incentives while resisting any change in personal tax rates.

Meanwhile, back in the corporate sector, the profit share of GNP has fallen to a postwar low and pushed capital spending into a decline rivaled only by that during the great OPEC slump of 1974–75. The squeeze on corporate pricing power and profit margins caused by high real interest rates and an overvalued dollar exchange rate has given a substantial boost to real personal income growth, which, on top of the tax cuts, is starting to produce an anemic economic recovery led by beer, cigarettes, fast food, and video games.

Adding to the weirdness of the whole spectacle is the explanation now being put forward by the administration for what went wrong. In recent weeks, monetarists at the Treasury, led by Beryl Sprinkel, have tried to set up the Fed as a scapegoat for the economy's ills. A year ago, they warned that the Fed might jeopardize Reaganomics by pursuing too easy a policy in 1981 and thus drive up interest rates by igniting new inflation fears. Money growth finished 1981 comfortably under target, so no one can accuse the Fed of having been too permissive. Instead, the new line from the Treasury is that money growth has been too volatile; that M1 and bank reserves bounce around too much from week to week, unsettling the markets and driving up interest rates.

Money growth, seasonally adjusted or not, *is* too volatile. But it is less volatile in this country than in many other Western economies where market interest rates are much lower. Moreover, if skepticism about monetary policy being restrictive were really the cause of high interest rates in the U.S., one also would expect to see evidence of such skepticism in the gold market, the currency markets, or the stock market. When Dr. Sprinkel criticized the Fed for being too easy in late June, practically all financial markets and commodity prices were at three year lows. Something else must be wrong.

Indeed, there is. Even Mr. Brittan is now telling his old friends in the American monetarist community that they are sailing off the end of the world in search of explanations for high interest rates which ignore the obvious causes: First, an imbalanced administration economic strategy imposed on an economy where severe Fed restraint came as a surprise and thus left many corporations short of the cash needed to finance inventory, capital spending programs, and wage agreements based on inflation assumptions that are now far too high. Secondly, an insular approach to monetarism which ignores the interaction between U.S. monetary policy and that in other countries. With the dollar so strong because of high interest rates, U.S. money statistics have been inflated by overseas demand for U.S. currency (which has no effect on domestic spending) while foreign central banks have had to pursue tighter monetary policies in order to prevent their own currencies from dropping further. Because of the increasing influence of international factors on domestic money supplies, Mr. Brittan is a strong supporter of Professor Ronald McKinnon's program to have the major industrial countries coordinate their money growth. That way excessive tightness in the U.S. will not produce a vicious cycle of restraint in other countries, plunging the whole world into a progressively more severe downturn.

What comes next? If the U.K. experience is any guide, the U.S. is probably headed for a new mix of monetary and fiscal policy. In 1981, the Thatcher government sharply increased taxes as a quid pro quo for an easier monetary policy and a drop in the sterling exchange rate. The budget was initially condemned by practically everyone, but today it is regarded as a turning point in stabilizing the U.K. economy despite the fact that the tax increase was equivalent to a stunning $60–70 billion in U.S. terms (adjusted for per capita income and population differences).

The first signs of a similar change in U.S. policy are already becoming apparent. In his recent testimony before Congress, Chairman Volcker announced a money growth target for 1983 which will not be any lower than the money target for 1982; that is a significant change from the Fed's previous policy of always reducing its money growth targets for the year ahead. In recent months, Chairman Volcker also has been downplaying the importance of targeting the narrow definition of money because of confusion about NOW accounts and how to measure the transaction demand for money (if that is still possible). Money growth targets will remain important, but they will be complemented as a policy anchor by judgements about real interest rates, commodity prices (not just gold, though), and the economy itself. Indeed, since the change in U.S. monetary policy in averting a banking crisis, the stock market surged up one hundred points.

Because of this November's election, the outlook for fiscal policy is more murky, but the budget deficit will have to be reduced if the administration is to alter the mix of economic growth more in favor of investment, housing, and exports and away from consumer spending. There will probably be a tortuous series of budget compromises affecting both revenue and spending growth. If the administration can retain control of the political agenda, tax increases will probably be indirect (sales and excise) rather than on income and be complemented by some movement towards a flat rate or narrow bracket income tax system. If they fail to control the agenda, we may lose income tax indexation as well as any intermediate-term momentum for more far-reaching tax reform. In any case, much of the new tax burden will ultimately have to fall on the personal sector, directly or indirectly, because the corporate sector is broke.

Whatever the specifics of future budget adjustments, the stakes in revising the administration's economic strategy are very high. If the economy stumbles along for another two years, there will be new financial accidents and unemployment will remain high. An American Mitterrand could emerge in the 1984 elections, forging a new political coalition combining the traditional public spending constituencies of the Democratic party with protectionist trade union and business groups in the depressed industrial states of the Midwest. By that time, there may even be strong pro-inflation constituencies in the commodity producing regions of the South and West.

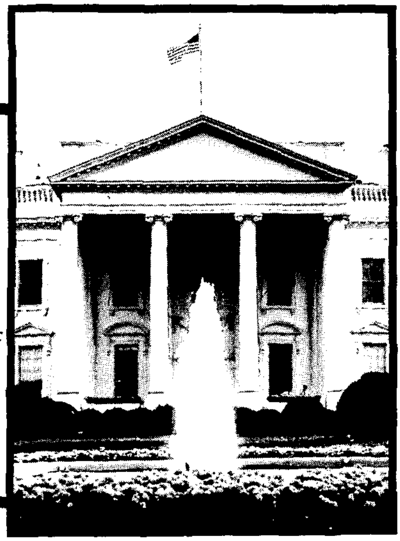
There are no simple miracle cures to the economic problems of the Reagan administration, but policy will be much more lucid and credible if the administration actually understands how the financial markets and the international economy have evolved since contemporary monetarist theory started gaining widespread acceptance ten years ago. In Sam Brittan's book, they will discover that even for a monetarist these days, central banking remains an art rather than a science.

David Hale

THE REAGAN EXPERIMENT

An Examination of Economic and Social Policies under the Reagan Administration

Edited by John L. Palmer
and Isabel V. Sawhill



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