

tion to exiles and dissidents.

Since World War II, a number of communist powers have appeared, many not under Soviet control. They share its unpleasant characteristics—aggressiveness, secretiveness, suppression of independent opinion, no orderly way of transferring power, economic inefficiency, and a low threshold for committing genocide. It wasn't the Russians who killed a quarter of the population of Cambodia. This suggests that it's not the Mongols who are to blame; it's communism.

Ignoring such facts leads to error in dealing with the nuclear-war problem. For example, Dyson thinks that we missed an opportunity in the late '40s to strike an agreement with the Russians about nuclear weapons that might have established some measure of trust. He doesn't even mention Stalin and deal with the evidence that Stalin never trusted even his fellow communists and always strove to get them under his thumb.

Communist doctrine as well as the personal characteristics of the leaders of these dictatorial regimes plays an important role in limiting the agreements that are possible. Most likely we cannot achieve substantial mutual trust with communist countries unless their societies evolve into more humane forms. But it may be that some of them will evolve into even more aggressive forms. Here Dyson should apply his own doctrine of living with uncertainty.

The fact is that we have avoided nuclear war for 40 years with a wide variety of policies. We should not let anyone stampede us into desperate measures of either military action or unilateral disarmament. Most likely nuclear peace will continue, but we will not soon achieve a world in which we will really feel safe. Dyson's book contributes to the moderation needed to live in this uncertain world.

John McCarthy is a leading researcher of artificial intelligence. He works at Stanford University.

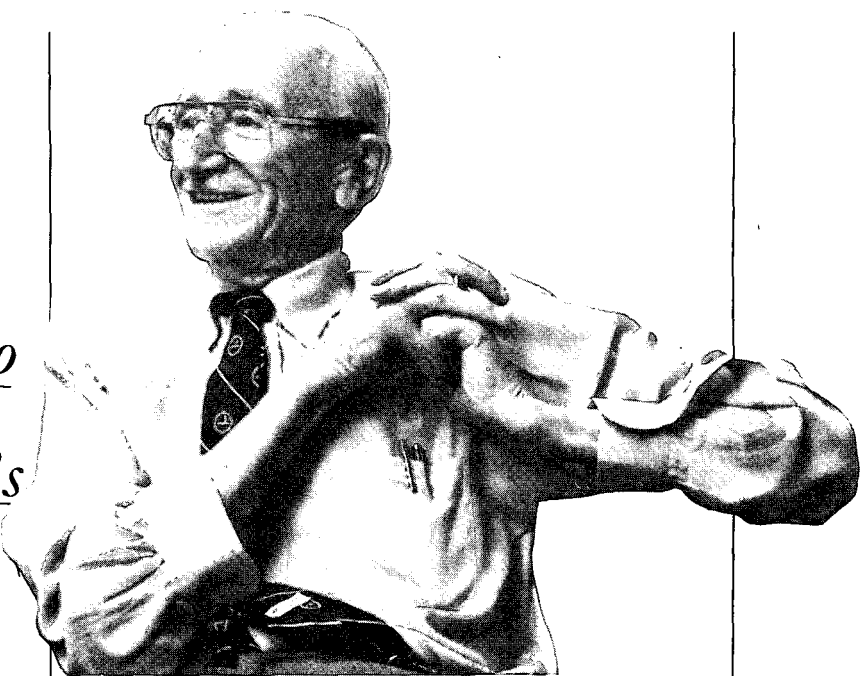
The Road to Freedom: F. A. Hayek's Intellectual Journey

By Jeremy Shearmur

Ten years after receiving a Nobel Prize, economist and political philosopher Friedrich Hayek is the object of more scholarly attention than ever before. But who is Hayek? Why is he the object of all this attention? And is he of importance to anyone except the professional academic?

Hayek is the grand old man of the classical liberal tradition in economics, where *liberal* has to do with freeing up the socioeconomic order. He has not only received a Nobel Prize but this year, at the age of 85, was awarded the Companion of Honour, a prestigious British title. In addition to being studied by scholars, his work is also often cited as an important influence on the thinking of politicians, including British Prime Minister Margaret Thatcher and US President Ronald Reagan. Even the popular media—witness *Time* in August 1984—are alert to Hayek's contributions. And so it is interesting to trace Hayek's intellectual development, to see how he came to gain such influence.

In some autobiographical remarks in a recent collection of his essays, *Knowledge, Evolution, and Society*, Hayek notes that as a young man he was a socialist. But in his



Friedrich Hayek: Economist, political philosopher, grand old man of the classical liberal tradition wherein liberalism had to do with freedom.

native Vienna in the 1920s, he came into contact with Ludwig von Mises, an economist in the Austrian tradition, and read Mises's critical work *Socialism*. Hayek thus became convinced that socialism could not achieve the desirable social consequences for which he had valued it.

Hayek was working at the time on technical problems in Austrian economic analysis. As a result of his work, Hayek was invited to give a course of lectures at the London School of Economics and subsequently to become the Tooke Professor of Economic Sciences and Statistics.

In his inaugural address at the London School of Economics, "The Trend of Economic Thinking," delivered in March 1933, he discussed general issues of social philosophy. The mark that Mises made upon him can be clearly seen in this address. For Hayek, while indicating that his fundamental values had not changed very much, there argued not for socialism but for classical liberalism. Indeed, he expressed some embarrassment that he found himself substantially in agreement about *means* with conservatives whose *ends*, or goals, he did not share at all.

The address anticipates

themes that characterize Hayek's later work. First, one sees that his attachment to (classical) liberalism arose not from a belief in individual rights but from a conviction that liberalism would deliver desirable consequences: that it would lead to the well-being of mankind. While Hayek later adds something approaching a theory of individual rights, it is always argument about the *consequences* of social arrangements that is characteristic of Hayek's work.

Second, Hayek is concerned about the way in which the institutions of a liberal society may be vulnerable. In a liberal society, public benefits flow from the pursuit, by individuals, of their self-interest. But unattractive self-interested behavior may be much more visible than are those benefits. Hayek thinks that liberalism is the best form of social order attainable, but he does not think that it is perfect. Hence, he is concerned lest citizens' awareness of its imperfections lead them to abandon it for the *promise* of something better.

Third, Hayek's inaugural address follows Carl Menger, the founder of the Austrian School of economics, in emphasizing the importance of

human institutions that are organic in character—the products of human action but not of human design. He suggests that we have inherited various institutions that are valuable but whose functions we do not understand. Thus, we should be cautious in our criticism of institutions and customs (for example, the market economy and common law) whose useful functions we may not fully appreciate.

The character of Hayek's liberalism perplexed British liberal economists. They found it a strange mixture of the economic ideas of classical liberalism with the illiberal social theory of Edmund Burke. But it has also perplexed many conservatives. Over and over again, they have tried to claim Hayek for themselves, only to be rebuffed, as in the appendix to his *Constitution of Liberty*, entitled "Why I Am Not a Conservative."

Shortly after his appointment to the London School of Economics, Hayek edited a collection of papers by various authors on the problems of economic calculation under socialism. It included the argument by Mises that had convinced Hayek himself that collectivist economic planning is a recipe for disaster. The collection also included a critical account by Hayek of some British socialists' attempts to answer the argument. The debate (which continues to this day) sheds light on Hayek's views and their development, for there emerge two themes—and a problem—that mark his long and fruitful career.

The first theme, set out in Hayek's 1944 bestseller, *The Road to Serfdom*, is that many of the features of "totalitarian" regimes are the unintended consequences of the attempt to put "socialist planning" into operation. Hayek became convinced that it is impossible to get the kind of agreement about social priorities that centralized socialist planning requires. Such planning may be attempt-

ed, but the attempt leads to problems for democracy. Democratic bodies cannot effectively resolve such disputes, and their failure leads to demands for "strong men" and for governments that will get things done: authoritarian governments.

The second theme to emerge

In *The Road to Serfdom*, Hayek wrote that many features of totalitarian regimes are the result of trying to put socialist planning into operation...

from the debate over economic planning was a new research program for economics that challenges the prevailing "general equilibrium" model of a market economy. In this idealized model, all supply and demand and prices and costs are brought into balance by repeated adjustments on the part of market participants. In the resulting state of equilibrium, all resources are allocated in the most efficient way possible. This model is a widely used tool of economic analysis and is often called upon as a standard by which to compare the results of various socioeconomic systems.

Such a view of the market *might* be argued to be implicit in Mises's initial criticism of socialist planning. And some socialist writers argued, in turn, from such a viewpoint, maintaining, against Mises, that the task of the central planner could at least in principle be accomplished by solving a mass of mathematical equations. This would simulate the result that, according to general-equilibrium theory, is achieved by the market.

Hayek, however, in his response to these writers, came to develop certain reser-

ervations about general-equilibrium theory itself. First, Hayek suggested, certain kinds of information emerge only through on-the-spot experience or through the fact that those with better knowledge win out in competition with others in the marketplace. He subsequently developed these ideas, arguing that markets are able to make use of knowledge that is essentially tacit in character—knowledge *how* rather than knowledge *that*; knowledge of a kind that would simply not be available to the central planner.

Then, in his 1937 article "Economics and Knowledge," Hayek also questioned economists' use of the idea of general equilibrium as an idealized end-state. He suggested that they should instead see markets as generating a *process* through which the plans of individuals are brought into better coordination with one another. This, together with Hayek's subsequent writings on the theme of competition as a process of discovery, has served to inspire much recent work within the Austrian economics tradition.

But what of the *problem* to

...but John Maynard Keynes countered that everything would be all right so long as power were in the hands of the right people—such as himself!

which I referred earlier? It is generated by these very same developments. For while Hayek has some strong arguments against central economic planning, one might ask: what has he to say to those who do not want to *replace* the market but want merely to have the govern-

ment intervene to further various goals, making sensitive use of market mechanisms? Hayek does respond to some such views—for example, to proposals that government should promote the concentration of industry. But in arguing that such proposals would lead to the misallocation of resources, he seems to presuppose the very general-equilibrium model that he was calling into question.

The problem is thus whether arguments against piecemeal governmental intervention can be derived from the new and interesting direction in which Hayek has led research in economic theory. This is a particularly pressing problem for Hayek, given the role of consequentialist arguments in his own case for liberalism. For Hayek, as noted earlier, moved toward classical liberalism because he became convinced that its consequences would be superior to those of socialism or "planning."

During the course of World War II Hayek wrote *The Road to Serfdom* as a consciously political work. But such a description diminishes it. Though it is a tract for the times, it is also a scholarly achievement of the first order, presenting a defense of liberalism together with an attack on central economic planning. It was written primarily for a British audience, who received it quite well; in the United States the book was a runaway popular success. The academic reaction, however, was much less friendly.

One particular reaction was most interesting: that of the British economist whose ideas would come to dominate post-war economic policy in the West—John Maynard Keynes. He accepted that Hayek had called attention to a problem, but countered that everything would be in order provided that power was in the hands of the right people—people whose hearts and minds were in the right place; people such as himself!

Much of Hayek's subsequent work presents an alternative to such an elitist liberalism. Hayek began paying increasing attention to the theme of the rule of law, attempting to formulate a version of liberalism that would avoid the need to give discretionary powers to the "right people." He also developed ideas about the limitations of human reason and tried to explain more cogently how we should approach inherited institutions so as to avoid damaging what may be worth preserving in them.

After World War II, Hayek moved from Europe to the University of Chicago, where he returned to an old interest of his: the psychology of perception. He set out his ideas in *The Sensory Order* (1952), perhaps the most difficult of Hayek's books. In it, he develops a theory about the role in perception of abstract and unconscious rules and procedures. From these ideas, Hayek draws support for his views about the limitations of human reason and implications for the methodology of the social sciences.

The phenomena that the social sciences are typically trying to understand, he argued, are largely the unintended consequences of human action. Moreover, they are complex (like the weather in the natural world), not simple (like mechanics, which can be comprehended with some idealization in simple mathematical equations).

In the social world, Hayek suggests, complex phenomena emerge from the interaction of individuals whose behavior is governed by rules and procedures of the kind discussed in *The Sensory Order*. If these complex results of human interaction are approached the same way as simple phenomena in the natural world, the wish to have exact knowledge—and to be able to make detailed predictions—will be frustrated. And the sort of knowledge that is attainable may be overlooked—knowledge that Hayek refers to as "explana-

Hayekiana

Knowledge, Evolution, and Society

By F. A. Hayek

London: Adam Smith Institute
Distributed by Laissez Faire Books (New York)
57 pp. \$4.95 paper

Money, Capital, and Fluctuations

By F. A. Hayek. Edited by Roy McCleoughry

London: Routledge & Kegan Paul;
Chicago: University of Chicago Press
196 pp. \$20.00

Hayek: His Contribution to the Political and Economic Thought of Our Time

By Eamonn Butler

London: Temple Smith
Distributed by Laissez Faire Books (New York)
168 pp. \$7.95 paper

Hayek on Liberty

By John Gray

London and New York: Basil Blackwell
230 pp. \$24.95

The Essence of Hayek

Edited by Chiaki Nishiyama and Kurt Leube

Stanford: Hoover Institution Press
405 pp. \$27.50/\$13.50

The Political Economy of Freedom

Edited by Kurt Leube and Albert Zlabinger

Munich: Philosophia Verlag (forthcoming)

Hayek's "Serfdom" Revisited

By Norman Barry et al.

London: Institute of Economic Affairs
Distributed by Laissez Faire Books (New York)
176 pp. \$8.95 paper

The Fatal Conceit

By F. A. Hayek

London: Routledge & Kegan Paul;
Chicago: University of Chicago Press (forthcoming)

tion of the principle."

For Hayek, more than just methodology is at stake. If we believe that we have such knowledge, we will overestimate our ability to control social phenomena. We may also ignore the merits of the social institutions illuminated by theories such as Hayek's own.

Hayek's time in the United States culminated with the writing in 1960 of what may be his major work, *The Con-*

stitution of Liberty. Hayek here restates the principles of classical liberalism and applies them to policy issues. He is also clearly concerned with the freedom of the individual not just as a means to an end but as something that demands respect for its own sake.

Even here, however, his ideas differ from those of many American individual-rights theorists. Hayek starts with the state as a received in-

stitution and would constrain it to minimize coercion, rather than taking individual rights that may not be infringed as the starting point and asking what role the state may then legitimately play. Hayek's concern with the rights of the individual does go beyond his earlier, more utilitarian approach. But he does not provide arguments for his new views that would have cut much ice with his own, younger, socialist self. In addition, his philosophical treatment of coercion leaves a lot to be desired. And his discussion of policy issues allows a bigger role for the state than many advocates of limited government would be happy with. He even seems willing to defend a measure of compulsory military service, at least if the alternative is life under constant threat of arrest by an arbitrary power.

Hayek does not rule out the idea of collective responsibility for aspects of individual well-being. And he accords the state limited responsibility for the relief of those in distress and for ensuring that individuals make provision for their own old age and infirmity, responsibility for ensuring that the young be educated, and diverse responsibilities in areas such as building-safety regulations. Yet he also considers—in some detail—how such tasks might be performed with the least possible coercion or damage to the well-being of individual citizens.

After *The Constitution of Liberty* was published, Hayek returned to the German-speaking world. He did not desert the cause of liberty in Britain and the United States, however, and published two collections of essays, *Studies in Philosophy, Politics, and Economics* (1967), and *New Studies* (1978), both of which contain many interesting developments of his work. In addition, from 1973 to 1979 he published a trilogy on political philosophy: *Law, Legislation, and Liberty*. This represents an impressive restatement and development of his views, in which he grapples with the

problem that political institutions designed to check the excesses of government have failed to achieve this task. The work finishes with a proposal for a new, liberal constitution.

The works of Hayek's later years contain many thought-provoking ideas. They also show an increasing tendency to stress the importance of inherited institutions and, to back this up, give increasing weight to social evolution. He sketches some controversial ideas about group selection that attempt to explain how we come to possess institutions that are not designed to have but do have desirable functional properties. Those groups who happened to adopt codes of conduct that proved useful have prospered, he suggests. They may also, in time, be imitated by those who were not, initially, so fortunate. Such "evolutionary" themes play an even larger part in Hayek's forthcoming work, *The Fatal Conceit*.

These, then, are some of the themes of Hayek's work. But do they merit the attention they are currently receiving? I believe they do, not just for the solutions that they offer but also for the problems they raise. For Hayek has put his finger on countless issues that are vital to the defense of liberty.

Any successful defense of classical liberalism must involve arguments both about individual rights and about the consequences of a free social order. Hayek's work has made contributions in both areas. But the difficulties in his views also provide a challenge to a new generation of libertarian scholars.

Yet to be resolved, for example, is the tension that arises between Hayek's research program in economics and the ability of the economist to make specific claims about the welfare consequences of a market order. As to rights, Hayek defends the importance of minimizing the coercion of the individual, but he does not present much argument that would impress

the person who thinks that, should they clash, social utility is more important than individual rights. On another front, Hayek's ideas about the evolutionary origins of ethical codes call into question why anyone *should* comply with these codes.

Hayek's work gives rise to



many other interesting problems, too. His ideas about the limitations of human reason and about the importance of custom and tradition are striking. But they seem at times to call into question our ability to accomplish even the rational appraisal and improvement of our institutions—let alone our ability to engage in the large-scale constitutional reforms that Hayek himself favors.

That such problems arise is in fact a sign of the strength of Hayek's views, not of their weakness. For Hayek's work brings out important issues that are masked in the work of lesser writers.

Moreover, there are arguments, especially about learning and the utilization of knowledge, that constitute formidable additions to the liberal arsenal. His discussion of freedom as the ability of individuals to utilize their own skills and knowledge and act on their own plans and judg-

ments is especially important. It is a vital rallying cry in a world such as ours, where paternalists and bureaucrats are imposing their own narrow vision and ignorance on the lives of their fellow citizens.

Hayek's views have practical use, too. For example, I

I know one entrepreneur led by Hayek's work to select a field in which he has been able to work with great success.

know one entrepreneur who has been led by Hayek's work to select a field in which he has been able to work with great success. For he has been led, by Hayek's work, to the perceived view that any area that has been dominated by government, rather than markets, is bound to be grossly inefficient and thus to be full of useful opportunities for achieving private gain and the public good! Similarly, in August 1984 the *Wall Street Journal* cited Robert Cross, the manager of system marketing at Delta Airlines, as having been inspired in the development of a new and very effective system of seat pricing by some of Hayek's work on prices and knowledge.

Given, then, the character and importance of Hayek's ideas, it is not surprising that his work is gaining so much attention these days. A whole range of new books is available. Hayek himself is not an easy read. But relief is at hand, as British economist Eamonn Butler has provided a readable introduction to the central themes of Hayek's writings in his *Hayek: His Contribution to the Political and Economic Thought of Our Time*.

Butler gives a brief but useful sketch of Hayek's life and work and then some particularly good surveys of his

ideas on the market process, socialism, social justice, and the character of a liberal order. His book will serve as a useful tool for anyone who wants an accessible overview of Hayek's main ideas.

The Essence of Hayek, edited by Chiaki Nishiyama and Kurt Leube (Hayek's former assistant), is a selection of Hayek's writings chosen to illustrate various major themes in his work. It includes some well-known papers, such as his "Individualism: True and False," some of Hayek's essays in the history of ideas, chapters from some of his books, and also some recent less-formal presentations.

The latter provide a useful introduction to his views, although they lack the richness of some of his more substantial works. On the other hand, some of the chapters from Hayek's books—notably those from *Prices and Production* and *The Sensory Order*—may prove a little too rich for newcomers to Hayek's work. Still, some problems of this sort are inevitable in any such selection, and this one makes available a lot of good material by Hayek.

The collection contains a helpful biographical introduction by Leube, which is followed by some useful suggestions for further reading. It also contains an introduction by Nishiyama that, long and often obscure, is a disaster as an introduction.

Leube is also the coeditor, with Albert Zlabinger, of a volume designed as a tribute to Hayek, *The Political Economy of Freedom*. The contributors include both philosophers and economists.

Among the pieces that especially impressed me were an urbane essay by William Bartley, in which he explains that he has learned from the philosopher Karl Popper that one never knows what one is saying and from Hayek that one never knows what one is doing. He then proceeds to use ideas from Popper and Hayek to criticize Karl Marx's central theme of alienation. Bartley's piece suffers a little

from being an attack conducted from the outside, thus doing Marx's views a *little* less than justice before moving in for the kill. (This is much more true, however, of a critical piece on Marx by Tibor Machan, which reads a little as if he had been let loose with a dictionary of quotations from Marx.)

Israel Kirzner, in what is perhaps the best piece in the book, discusses two different ways in which Hayek's ideas about the role of prices in conveying information may be interpreted, depending on whether or not a system is in equilibrium. Other contributors include Thomas Sowell with a well-written informal piece asking *whose* freedom has been adversely affected in our society (not the intellectuals who advocate more planning), Leland Yeager with a spirited piece in defense of utilitarianism (although his case is weakened by his not distinguishing between consequentialist arguments in general and utilitarianism), and Laurence Moss with an able application of *The Road to Serfdom* to current proposals for government "reindustrialization."

The British Institute of Economic Affairs has also published a volume of essays on Hayek's work, *Hayek's "Serfdom" Revisited*. The contributors (of whom I am one) have all written directly on issues emerging from Hayek's famous tract. An Icelandic, Hannes Gissurarson, writes of the varied responses to Hayek's book when it was first published (and for which he recently won the Mont Pelerin Society's Olive W. Garvey prize). Norman Barry addresses the interesting tension, in different strands of liberalism, between an emphasis on the historical role of ideas and on people's interests. John Burton argues for the instability of that "middle way" between socialism and liberalism that, as he says, "has been widely adopted in the Western world because it sounds inherently reasonable and judicious."

Karen Vaughn offers some reflections on the decline of liberal regimes but concludes suggesting that this decline can be reversed by ideological activism. This attractive short volume is prefaced by some fascinating historical reflections, in part autobiographical, on Hayek and liberalism in Britain, by Arthur Seldon of the Institute of Economic Affairs.

John Gray is another contributor to *Hayek's "Serfdom" Revisited*, discussing some criticisms of Hayek's classic. Gray has also written a magnificent book, *Hayek on Liberty*, which grew out of a long article on Hayek written for the journal *Literature of Liberty*. The book contains a revised and expanded version of the *Literature of Liberty* bibliography of Hayek's work and of writings—published and unpublished—about him. For this reason alone it would be valuable to Hayek scholars. But Gray has also given us an impressive and serious study of Hayek's work.

Gray's book, while not uncritical, presents a sustained case for the importance of Hayek's work. He is a most-stimulating writer, although at times a little opaque—I was in places left wondering whether he himself is clear about what he wants to assert. He also loses sight, in offering his interpretation of Hayek's

If today's free-market scholars display half of Hayek's energy and originality, the world will be safer for liberty.

thought, of some important aspects. One would not realize, for example, just how large a role Hayek is at times prepared to allow the state. And as a noneconomist, Gray is surprisingly willing to take Hayek's economic ideas as uncontroversial.

Still, it is a first-rate piece of work and will undoubtedly be

the starting point for academic work on Hayek for many years to come. And non-academics should not hesitate to skip over material that seems difficult to understand (some of it is!) or take up Gray's original piece in *Literature of Liberty* for an easier read.

Two other recent books are also worth mentioning. Both consist of essays by Hayek himself. The British Adam Smith Institute has published *Knowledge, Evolution, and Society*, a small collection of Hayek's lectures, which constitute popular presentations of his recent ideas. Though they do not contain much that is new, they are very readable. Moreover, they contain interesting biographical information about Hayek's early socialism and the impact of Ludwig von Mises on Hayek's work.

The other volume, *Money,*



Capital, and Fluctuations, is a collection of Hayek's early papers on economics, newly translated from the German. It will interest those with a special concern with the development of Hayek's views. The introduction by Roy McCloughry, who has written a dissertation on Hayek's economic thought,

unfortunately does not explain the intellectual context of these pieces, limiting their ready appreciation to those already familiar with this period in the history of economic thought.

In reviewing Hayek's work, and the scholarly reactions to him, we cannot but appreciate the contribution that he has made to liberalism in our century. Given his European background and his socialist origins, some aspects of his thought may not appeal very much to an American audience. For free-market individualism in the United States is more associated with a rights-based approach, and even Austrian economics has been more associated with Mises than with Hayek. But Hayek's work, even where it is not fully successful, represents a valuable resource and a starting point for new work. And if free-market scholars of this generation can only display half the energy and originality of Hayek's work, the world will be a safer place for liberty.

Finally, if I may be so bold as to say, it is the world, not just the United States, that matters. Even those who have little sympathy for the consequentialist and utilitarian aspects of Hayek's work might remember that, in a world where there is little concern for the rights of individuals, it may be arguments of the kind that Hayek has offered that will have the most impact. And while Hayek might not have moved far enough for some, he did make the move from socialism, to the adoption of liberalism on utilitarian grounds, to an eventual appreciation of the freedom of the individual as important in itself. And this is a path that others may follow in their turn. □

Jeremy Shearmur teaches political thought at the University of Manchester in the United Kingdom. He wrote this essay while on a fellowship at the Institute for Humane Studies in Menlo Park, California.

VIEWPOINT

The Recovery They Love to Hate

BY JAMES ROLPH EDWARDS

You'd think everyone would have been happy about the economic expansion experienced this past year. But if anything has been more surprising than the recovery's strength and apparent endurance, it has been the associated attitudes of the news media and the economic analysts whose views they report. Never has a healthy economic expansion been accompanied by such constant expressions of trepidation and anguish! Nightly we have been told that "economists" fear that rising interest rates resulting from excessively rapid growth will choke off the recovery.

Now consider the logic here: Rapid growth makes interest rates rise; higher interest rates reduce growth; so we should have slower growth to prevent the higher interest rates that reduce growth! It is perhaps significant that this bizarre argument is always attributed to unnamed economic analysts. I, too, would be reluctant to have my name attached to such reasoning.

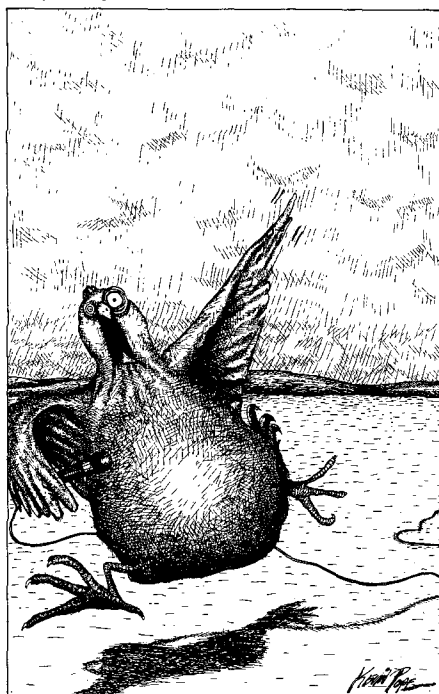
Even the basic assumption of the argument can be shown to be false. Economic growth does indeed lead to higher interest rates as businesses seek loans to expand operations. But interest rates that rise *because* of increased credit demand attributable to economic growth must necessarily be associated with *increased* (not decreased) credit extended—and hence must increase, not reduce, economic growth.

This is demonstrably what has happened. Interest rates on financial instruments began rising in May 1983 and continued through July of this year. The prime rate (the rate charged by banks to their largest customers) began rising in August 1983. But business loans, rather than falling, started increasing rapidly in October 1983.

By the fall of 1984, evidence of slower growth was emerging (greeted with euphoria in the media). But this was *not* because the expansion made interest rates rise. The amount of credit extended would decline (resulting in a recession) only if interest rates increased because of a reduction in the *supply* of credit. That is usually a consequence of action by the government, via the Federal Reserve, to severely reduce the rate of growth of the money stock.

Some of the confusion and misinterpretation of the current expansion may be a legitimate result of its unusual character. All previous post-Korean war recoveries have been *demand-side* expansions. In each case the Federal Reserve had caused the prior recession by reducing money-stock growth (to fight inflation). But then, under pressure to cure the resulting unemployment, the Fed responded with rapid expansion of the money stock, increasing the demand for goods, services, and labor—and inducing another round of inflation.

Of course, none of this was ever necessary. Any one of those recessions would



have ended without the Fed undertaking rapid monetary growth. If the rate of growth of the money stock was kept low and steady, the inflation rate would sooner or later fall below it.

This would take a little longer than it does for the Fed to "inflate" the economy out of a recession. If it had been done once, however, and inflation had thus been controlled, the whole series of subsequent contractions and expansions would have been avoided (with the exception of the OPEC-induced recession of 1974).

One of the things that is different about the current expansion is that we may

have done exactly what could have been done earlier. During the recent contraction, the Fed kept monetary growth low for so long, in the face of massive pressure to reverse course, that people became convinced that for once it *really* meant to control inflation. Inflation and the rate of expected *future* inflation (and hence interest rates leading up to the expansion itself) all fell.

The second thing that is different about this recovery is that it is a *supply-side*, not a demand-side, expansion. Alterations in the growth of the money stock can only cause temporary fluctuations in the growth rates of output and employment around their trends. To increase the trends themselves it is necessary to increase the incentives people have to work, save, and invest in productive equipment. And the best way to do *that* is to lower tax rates on the income earned from such activities.

Liberals who opposed supply-side from the outset have tried to portray the expansion as being led by consumer spending, rather than supply-side factors. But in fact savings are up, and consumption spending as a *proportion* of disposable income is down.

Investment spending also tells a supply-side tale. Personal consumer spending rose at a 4.6 percent annual rate in the first quarter of 1984 and at a 6.9 percent rate in the second. But at the same time capital spending by business was soaring at a 20 percent annual rate. Meanwhile, productivity is up, and the rate of new-business formation and job creation in the last year have been the highest in decades.

The most surprising aspects of this expansion, such as the unexpectedly high growth rates of GNP (10.1 percent per annum in the first quarter, 7.5 in the second) and the persistently low inflation rates, are best explained by its supply-shift character. And that also explains why the reporting of all this good news has, in the liberal media, been characterized by palpable fear and loathing. For the supply-side vision accords individuals a lot more economic freedom than liberals are wont to concede.

James Rolph Edwards teaches economics at Hillsdale College.