

## IF NOT NOW, WHEN?

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If not now, when? If not us, who? Those rhetorical questions set the tone of Ronald Reagan's presidential campaign in 1980. The answers, we thought, were a clear and determined commitment to a program that would slow the growth of money to reduce inflation and slow the growth of government spending to shift resources from consumption to investment and increase productivity growth.

The current answers to those questions appear to be: someone else. — some other time. The current aim is to force a recovery of consumer spending by pushing short-term interest rates to the point where consumers or business become willing to borrow and buy. That old nostrum — faster money growth — that produced the rising average rate of inflation of the past fifteen years has been dusted off, warmed over and put to work.

We leave to others the task of explaining why Ronald Reagan's program did not become Reagan administration policy. The fallacies of the original supply side rhetoric were recognized by most professional economists, including many within the administration, before the tax cuts were adopted. From the summer of 1981 on, the Office of Management and Budget (OMB) pressed for reductions in the growth of spending to complete the fiscal program of shifting resources from public to private use and increasing investment in plant and equipment. Unfortunately, the emphasis at OMB shifted to tax increases after the initial failure to reduce the growth of spending.

The Federal Reserve never accepted the President's program of *sustained, gradual, persistent* reductions in money growth. Instead, they have given us another round of slam-bang policies that produce alternating periods of excessive monetary contraction followed by excessive expansion. These policies are a principal cause of the recessions, high and variable inflations and the prolonged stagnation

that this administration promised to end. Yet, those within the administration who opposed the overly rapid reduction of money growth in 1981 and the excessive variability of money growth are now silent or gone.

The first step of the administration's fiscal program was to cut taxes. But tax cuts without reductions in the growth of spending create uncertainty about how spending will be financed. The necessary second step – required to make the tax cut permanent – is a reduction in the growth of government spending. Incessant harangue in the media suggests that this was achieved by gutting social programs. This is far from the truth. The major social spending programs have not been reduced. Many of the reductions in spending have come from government investment in highways, buildings and bridges. These are not permanent reductions, as the recent highway program demonstrates.

Taxes have not been reduced permanently. An approximate measure of the average tax rate is the share of government spending in total spending. The difference between the last spending projection of the Carter administration and last year's projections by the Reagan administration for 1983 to 1985 are less than \$10 billion per year in constant (1972) prices, about 2% of total projected spending and much less than 1% of estimated real GNP.

A main reason given for abandoning the administration's fiscal and monetary program is that unemployment is high and the danger of depression is great. The media, Wall Street savants and others have so often described our condition as a "depression" that is now repeated as fact. Yet the differences between the depression of 1929-32 and the stagnation of 1979-82 are large and the similarities few.

Aggregate real output is not 25 to 30% lower than three years earlier, as it was in 1932. It is about the same. Employment, also, is about the same as in 1979. Unemployment has increased to nearly 11% because the labor force has grown while the number of jobs has not.

The economy is stagnant. Stagnation did not originate with the Reagan administration and is not confined to the United States. It is true that stagnation in the United States contributes to stagnation

in western Europe and Japan, but stagnation in western Europe and Japan contributes to stagnation in the United States. Stagnation began before that administration took office. Their failure is a failure to adopt policies that would end stagnation.

The conventional view is that without fast money growth, or even with it, the recovery will be slow and inflation will remain low or even fall as the economy recovers. Many of those who repeat this view rely on econometric forecasts. It is worth noting that the *average* error in thirteen quarterly forecasts of real growth for one quarter ahead is between 2 and 3-1/2% at annual rates for a recent five year period. Year ahead forecasts of inflation and real growth have average errors of more than 1% and frequently miss by 2% or more. The errors of forecast are so large that one must be skeptical about their value. They are a poor basis for any policy that seeks to achieve lasting recovery and lower inflation.

There is another, more fundamental reason for skepticism about the conventional view. Most forecasts treat the economy as closed and ignore the effect of currency depreciation and appreciation on the prices and output. Yet, changes in the value of the dollar are likely to have a decisive influence on the speed with which inflation returns and on the extent to which current monetary policy increases production and employment in 1983.

Suppose the Japanese, French, Germans, Canadians and others decide not to inflate their economies as we inflate ours. Instead of holding the dollars we spend on their goods, or purchasing U.S. government bonds, suppose foreign governments let the dollar decline in value as they did in 1978 and 1979. Imports become more expensive for us, and our exports become cheaper for foreigners. We get a bigger spurt of growth in domestic output than the forecasters predict but inflation returns more quickly, as it did in the Carter years.

Foreign governments may, instead, decide to inflate their economies as we inflate ours. They use the dollars we spend on foreign cars, trucks and other durables to buy some of the bonds the U.S. government must issue to finance the massive budget deficit. The purchase of our bonds by foreign central banks helps to finance our budget deficit and keeps the dollar from declining. But the purchase of bonds by

foreigners means that they exchange their goods for our bonds. Final sales in the U.S. rise more than production. The difference is made up by imports.

Which outcome is more likely? Do we get a declining dollar and more domestic inflation? Or, do we get a more stable dollar, worldwide inflation, slower growth of domestic output and more imports? We see no way to decide which is the more likely outcome. Yet, the accuracy or inaccuracy of the common forecast of slow recovery and declining inflation depends on the answers foreign governments and central banks give to these questions and on other events that cannot be predicted reliably. What merit is there in resting our chance for future growth and an end to inflation on predictions of this kind?

When the hyperbole about depression and the massive budget cuts is forgotten, a few facts will remain. The Congress and the administration have failed to reduce the growth of spending. Instead they have pressured the Federal Reserve to inflate. A main difference from the past is that inflation will not reduce the deficit unless Congress repeals tax indexation. We expect the demands for an end to indexation to mount.

The Federal Reserve has done about what it always does. Money growth declined during the recession, making the recession worse, and money growth has been rising during the recovery establishing the base for the next round of inflation. Neither we, nor others, can predict with precision when inflation will increase. We have no doubts, however, that maintaining current high rates of money growth will increase inflation. And, if the current excessive money growth is followed by another shift in priorities, we will again have slow money growth and will take another recession.

We urge the administration to turn away from fine tuning and implement the program it was elected to carry out. That program calls now – as it has in the past – for reductions in the growth rate of spending in 1984, and future years and reductions in the growth rate of money from the current levels.

Neither the spokesmen for the Federal Reserve, nor the savants of Wall Street nor the pages of print about new types of money can make 8% growth of the monetary base, (currency and bank reserves) or the nearly 9% growth in  $M_1$  (currency and checking deposits) in 1982 into a non-inflationary monetary policy. We are back to the type of monetary policy characteristic of the Carter years. If these policies could produce stable real growth with increasing productivity and falling inflation, Jimmy Carter would, most likely, still be president.