

## **-VII. Economic Policy and Material Prosperity-**

From one perspective, governments have been *the* major obstacle to economic growth in this century.

Communism was a century-long economic disaster that has retarded the economic development of half the human race. Nazism and its tamer fascist cousins were nearly as inept as Communism at nurturing economic growth, were worse than Communism in starting wars—and were, fortunately for all of us, much less effective than Communism in mobilizing for and winning the wars that they had started.

But that is not all. In the industrial core of the world economy, the twentieth century has also seen governments from Herbert Hoover's to Jimmy Carter's that proved themselves singularly inept at managing market economies: inept at coping with the economic shocks that threatened to and did cause mass unemployment or raging inflation. Among the developing countries, a number of governments appear to have possessed the inverse of the Midas touch: everything they touched turned to lead.

Some failures came about because economists did not know what to prescribe: the history of economic policy reads like alchemy, not chemistry. Proposed remedies made economic problems worse: consider Herbert Hoover's insistence—applauded by the eminent among economists of the time—on slashing government spending and so reducing total demand for goods during the slide into the Great Depression. Some of it is that politicians did not like to follow their economists' advice, or sought for a more complaisant set of economists who would give advice that would be more politically pleasing and palatable to follow.

The net result was a set of economic policies and policymakers that have, taken all in all, done a lousy job at managing the business cycle—and a widely varied job (a few excellent, most mediocre, and some horrible) at encouraging long-run economic growth.

## **A. Social democracy**

### **1. The social insurance state**

Yet there is one sphere of activity in which the governments of modern industrial economies have been by and large successful. Call this “social democracy”—the construction of the infrastructure necessary for the private economy to flourish, the provision of “rules of the road” that have kept the economy a positive-sum enterprise, and the construction of systems of “social insurance” to greatly diminish the vulnerability of individuals and families to the individual and collective economic catastrophes that might befall them.

In the United States today social democracy includes the interstate highway system, airport construction, air traffic control, the Coast Guard, the National Parks, government support for direct research and development through agencies like the National Institute of Standards and Technology, the National Oceanic and Atmospheric Administration, and the National Institutes of Health. It includes the antitrust lawyers of the Department of Justice and the Federal Trade Commission, the financial regulators in the Securities and Exchange Commission, the Office of the Comptroller of the Currency, the Federal Reserve, and the Pension Benefit Guarantee Corporation.

It includes the National Labor Relations Board to regulate and guide the bargaining between workers and employers. It includes the promise by the federal government to insure small bank depositors against bank failures. It includes Social Security and all of its means-tested and non-means-tested cousins—Supplemental Security Income, Food Stamps, Temporary Assistance for Needy Families, and Head Start. It includes (with much less success) farm subsidy programs.

None of these programs would be seen as a proper use of the government by even a moderate libertarian. None of them fit under the definition of the “night watchman” state.

## 2. Political and economic success

These social insurance programs—together with local provision of police and fire protection, and of public schools—are the government, or at least that part of the government that is not national defense. And over the twentieth century as a whole these government programs and their analogues in other advanced industrial countries have been remarkably successful.

They have been remarkably successful in two ways.

First, they have been *politically* successful. Voters distrust politicians who seek to cut back on the major programs of the social insurance state. Voters find taxes earmarked to support social insurance programs less distasteful than taxes that flow into general revenues.

Second, the developed social insurance state has proven successful at providing social insurance, and reducing poverty in this century. The “safety net” has provided the middle class with substantial insurance that economic or personal disasters will not leave them wholly impoverished.

Whether called “mixed economy,” “social democracy,” or “social market economy,” the major business of government has become social insurance: progressive tax systems, income support, and benefit provision programs to partially counterbalance the extremes of economic inequality produced by the market distribution of income, and to create countries that are more middle-class societies—even though its redistributions of wealth have been primarily within the middle class, rather than to the relatively poor.

Economists have always tended to judge these social insurance states relatively harshly. Because most of their redistributions have been from the middle class to the middle class, economists tend to assess them as having no positive effect—mere churning of the income distribution. And because such redistributions affect marginal tax rates, economists worry about the adverse incentive effects of such programs.

Yet there is a sense in which economists’ views are too narrow. For the underlying logic of social insurance is the political and cultural logic of

universalism: social insurance provides rights and services that are yours by virtue of your standing as a citizen—and voters are much more likely to judge such universal rights and services as just than the array of means-tested benefits that would maximize economists' leveling, Benthamite social welfare functions.

### **3. Relative failure: the “commanding heights”**

In only one significant sphere has social democracy been a failure: its ventures into public ownership and operation of industry—government control of the so-called “commanding heights” of the economy.

In retrospect the most puzzling aspect of twentieth-century social democracies is the insistence on government provision of goods and services—not government demand, not government distribution, but government production. All over the world the belief that large chunks of productive industry ought to be publicly-owned and managed dominated the mid-twentieth century, and is still present—although in retreat—at the end of the twentieth century. And as a result railroads, coal mines, power generating facilities, steel works, chemical factories, hospitals, and schools became state-run enterprises.

This is puzzling because governments' core competence has never been in running a hospital, or a steel mill, or a railroad. Such organizations ought to be run with an eye on efficiency: getting the most produced with the resources available. But governments' logic of operation is very different: it is a logic of the political adjustment of conflicting interests. As a result, all over the world in the mid- and late-twentieth century, government-run enterprises—whether the coal mines of Britain or the telecommunications monopolies of western Europe or the oil-production monopolies of developing nations—were overwhelmingly inefficient and wasteful. And it was the recognition that the scope of enterprises that should be run by governments (as opposed to those that should be producing to satisfy government demand, or that should be regulated by government) was relatively small that provoked the mass drives toward privatization that started in Britain under Prime Minister Thatcher in the 1980s.

Now there are times when you do not want “efficiency”—at least not in the sense of maximizing the total amount of *measured* output given the available resources. There are times when you want “soft” rather than “hard” incentives: a health clinic that is paid by insurance companies should not be replacing antibiotic solutions with colored water in order to decrease its costs. A company running an electricity distribution network should not skimp on maintenance of the system as a whole in order to boost its current profits.

But the cases in which “soft” incentives are desirable are not that many. Ultimate consumers must be poor judges of quality, or must be unable to vote-with-their-feet by switching to alternative suppliers, or there must be no alternative suppliers to switch to before one reaches the stage where one would rather rely solely on the professionalism and the pride of accomplishment and usefulness of the producers and eschew the material incentives for efficient performance provided to the for-profit enterprise in market context. And even in those cases, regulation is often a much more attractive alternative than is public ownership and management of the enterprise.

As best as I can judge, the sources of demand for public *ownership* of the “commanding heights” of the economy had three sources:

- First, an inordinate fear of monopoly: a belief that economies of scale would ultimately lead to the domination of one single firm in most industries, and that that one single firm would exploit the public unmercifully if it were not state-owned.
- Second, a fear that the monopoly bosses would own the government: that regulation would be ineffective because the monopoly bosses would simply buy off the regulators, and that only public ownership that destroyed the monopoly bosses could avoid this problem.
- Third, the echoes of the classical Marxist belief that the market was inherently corrupted by exploitation—and that such exploitation could be avoided by eliminating the private ownership of the means of production.

All of these sources seem naïve to us now. If the market is inherently corrupted by exploitation, what do we now think of bureaucratic hierarchies? In the aftermath of the falls of U.S. Steel, GM, and IBM, monopoly power appears to be much less stable and durable—and economies of scale much less prevalent—than they seemed to our predecessors. And there are many

votes to be gained in elections by protecting the people from the dominant monopolists.

Yet if the social-democratic governments that dominated the industrial core in the second half of the twentieth century took a big misstep, it was in its belief that the government had a powerful role to play not just in managing demand and investment but in operating businesses.

#### **4. Rough politico-economic stability**

The existence of social democracy had one more powerful consequence. It played a large role in drawing the fangs of potential revolutionary movements.

A standard nineteenth-century fear among the elite was that the possible arrival of universal suffrage would see the end of economic growth: redistributive and confiscatory taxation would destroy enterprise and provide bread and circuses to the working class—which would then succumb to the flattery of ruthless demagogues. Dire analogies with the Roman Empire were drawn. When the French dictator Napoleon III reviewed the army, the cavalry cried “Viva the sausages!,” for Napoleon III had staged banquets for the army—he got credit for the banquets, but the taxpayers had paid for them.

Yet the social democratic regimes found in industrial economies in the second half of the twentieth century have exhibited remarkable stability in democratic institutions, and remarkable success in preserving incentives for entrepreneurship, investment, and enterprise. With the social insurance state in place, the risk of penury and destitution has been sufficiently diminished that further drives toward the confiscation of the wealth of the risk have not been on the political agenda. The ability of social democracy to deliver more-or-less constant economic growth has created a powerful consensus in favor of the current status quo.

Thus the past fifty years in the industrial, democratic west marks one of the few eras in history in which the distribution of wealth and economic power has been to a degree the result of political choice, instead of the distribution of economic power largely determining political organization. Opposing

pressures have balanced: populist calls for taking "unearned increment" from the rich balanced by an admiration for entrepreneurs and savers, and a realization that economic life is a positive sum game; compassion toward the poor balanced by resentment of those seen as trying to get something for nothing—even if the something is small by middle-class standards.

Pressures from the left that existing inequalities are “savage” have been balanced by pressures from the right that the mechanisms of the social insurance state are economically “inefficient” and have slowed growth. From my perspective the consensus is too far to the right--we tolerate much more poverty than we should in the name of "incentives" and "entrepreneurship". But even on the right there has been for more than half a century solid recognition that social democracy is *politically* necessary to maintain democratic support for the market economy.

## **B. Race**

At the start of the twentieth century governments—governments that ruled practically everywhere, for Africa and Asia save China and Japan were colonies of European empires—were white men’s governments. Australian and Californian voters alike overwhelmingly agreed that a principal function of government was to keep Asians out. In the United States the federal government had long since withdrawn from its immediate post-Civil War commitment to “reconstruction,” and more than acquiesced in the principle that state governments existed to keep African-Americans down. Segregated schools for African-Americans in the early years of this century met for fewer than one-third the hours that schools for whites met.

The principles of equal opportunity and meritocracy stopped at the color line. And the line separating those who were white from those who were not was very tightly drawn. Were people from southern Italy white? Maybe. Were people from Slovakia white? Probably not. Inhabitants of Calcutta or Bombay who wished to sit for examinations required for high office in the British administration of India could do so--but only if they travelled to London to take the exams.

At the turn of the century racial attitudes had taken several steps backward from what they had been half a century before. In the late 1850s Abraham Lincoln--debating Senator Stephen Douglas--could call, and find it politically popular to call, for equality of opportunity across racial lines: that while he, Lincoln, did not think that the Negro slave was Lincoln's intellectual equal, in the slave's right to earn his own bread by the sweat of his brow, "he is my equal, and the equal of all that have ever lived."

In 1900 few if any American politicians would have said that the government ought to be neutral between citizens of European-American and of African-American descent.

Yet by the 1960s everything had changed. In the United States, at least, and at the level of political rhetoric, at least, the commitment to color-blind equality of opportunity was absolute; and there was even some recognition that "affirmative action" would be needed to create a truly level playing field. And as President Lyndon Johnson recognized, true equality of opportunity would require affirmative action to repair deficiencies and gaps that had been generated by previous oppression and discrimination.

The--incomplete--creation of a multi-ethnic and multi-racial society in the United States, and the hesitant steps toward a truly multi-national Europe, are enormous--albeit partial--achievements. To some degree we owe them to the Cold War: it is difficult for a society practicing explicit racial apartheid to claim to be the "free world", and this tension undermined support among conservatives in the United States: fear of the Communists outweighed distaste for Africa-Americans. To some degree we owe them to the working-out of liberal principles: government by the people *means* universal suffrage; government for the people *means* equality of opportunity. To some degree we owe them to the political machines of America's northern cities, which had much experience at taking politically-unsophisticated migrants to the city and turning them into powerful and directed political forces by block-by-block organization: African-Americans in the southern United States were disenfranchised, but African-Americans who migrated to the northern cities in the twentieth century could rapidly become part of a political coalition to elect mayors and representatives.

But most of it we owe to political courage. Slavery proved compatible with America's democratic and republican values for ninety years (and would have proven compatible for much longer had not the defense of slavery

become attached to the dissolution of the nation). Racial apartheid proved compatible with America's democratic and republican values for a hundred years. A few less brave leaders in the 1950s and 1960s, and American race relations today might well still be frozen in their 1950s pattern.

## **C. Governing the business cycle**

The political and economic balancing act that is social democracy appears stable—appears possible—only when economic growth continues. And the record of the twentieth century is that modern mixed economies are not stable, and require the most delicate management to avoid economic chaos. Much of post-World War II discussion among economists has been consumed by sterile debate over whether the market economy is “naturally” “stable” or not. The answer is obvious: that if the government acts properly to reinforce the stabilizing factors and counteract the destabilizing ones, then the market economy is stable. But if government policy is improperly tuned, then it is unstable. The proof of the pudding lies in what policies are stabilizing and what policies are destabilizing.

### **1. Investment and expectations**

Go to Wall Street. Look around. Wall Street is, in a very real sense, the investment planning department of the human race. Power to purchase commodities that owners of property have earmarked for savings flow into Wall Street and, in a complicated social and economic dance, are distributed to enterprises and bureaucracies seeking permission to invest, develop new enterprises, or expand old ones.

The future becomes visible only slowly: one day at a time. Our technological capabilities, individuals' preferences for spending and saving, and natural resources change very slowly. Thus Wall Street should be a quiet place. Financial prices are the shorthand that Wall Street-considered-as-investment-planning-department uses to assess the desirability of investment projects. They should move glacially, as an extra day's information causes forecasters to revise so very slightly their image of the economy's

bottlenecks twenty years down the road.

But this is not how Wall Street works.

## **2. Financial crises**

At the end of 1994, for example, Mexico was for sale at fifty percent off. The valuation of all things Mexican, whether the cost of employing a worker, the value of a house, the worth of Mexico's currency, or the long-term profits to be gained from investment in a Mexican enterprise, is today fifty percent less than what it was in the late summer of 1994. If you had wanted to buy insurance against a fall in the peso in the late summer of 1994, you could have done so extremely cheaply. Few saw a peso collapse of the magnitude seen in the winter of 1994-1995 as possible; no one saw it as likely.

What caused such a change? In part, financiers now believe that they were overoptimistic about the economic future of Mexico. In large part, however, financiers concluded that other financiers' downgrading of Mexico meant that Mexico would be starved of capital and short of international means of payment, and that as a result of this shift in mood the Mexican economy would perform more poorly.

This is an old story: a regime that bet a large chunk of its chips on rapid industrial development financed by capital inflow from world financial markets finds itself suddenly subject to a panic. In the United States, 1873 saw British investors lose confidence that American railroads and infrastructure were that day's equivalent of investments in the Pacific Rim. The largest investment house in the United States-that of Jay Cooke, politically well-connected industrial visionary who financed Abraham Lincoln's armies, and whose picture the Treasury Department's antique custodians will not release for me to hang in my office-went bankrupt.

Then there was no International Monetary Fund, no Bank for International Settlements, no Exchange Stabilization Fund, no one willing to guarantee the liquidity of the financial system that had funneled capital to America from Europe. As a result of the collapse of Jay Cooke and Company the City of London sneezed. The U.S. economy caught pneumonia. The share of

America's non-agricultural labor force building railroads fell from perhaps one in ten in 1872 to perhaps one in forty by 1877—a seven percentage point boost to non-agricultural sector unemployment from this source alone.

Now we have a keen awareness of what is lost when a crisis of confidence is allowed to lead to the unraveling of a financial network. We have governments and institutions willing to take action. Unlike the United States in the 1870s, Mexico in the 1990s will not undergo anything near to a great depression.

Nevertheless, for at least three centuries capitalist financial markets have been working their erratic will. No one has a preferable alternative to allowing financial markets to do our collective investment planning: Wall Street's vision of where investment capital should be directed is infinitely better than the vision any group of planners. All would agree that financial markets require the most delicate political regulation and management.



*Note:* incorporates revisions to pre-Great Depression unemployment estimates suggested and calculated by Christina Romer.

*Source:* *Historical Statistics* (Lebergott unemployment series), *Economic Report of the President 1994*, Bureau of Labor Statistics January 1995 *Monthly Employment Release*, Christina Romer.

But it is rare that you find any two agreeing on exactly what form that political regulation and management should take. Moreover, the entire system can lose forward motion completely. It is possible to mismanage a capitalist economy so badly as to bring a halt to essentially all economic growth. Consider Argentina, on a par with France and ahead of Italy in GDP per worker, agricultural productivity, and some areas of industry in 1950. Yet Argentina today may have no higher a standard of living than it had in the aftermath of World War II. Consider the Great Depression, when U.S. unemployment hit 25 percent of the labor force, and stayed above ten percent for a full decade.

The world economic system *is* more fragile than anyone would wish and *has* gone completely off its rails once in this century.

Governments balance conflicting goals: high investment to boost productivity growth, stable prices so that private economic planning decisions focus on productivity rather than on exploiting quirks in the price-adjustment process, and high employment. The terms of the tradeoff are lousy. Election cycles tend to emphasize short-term as opposed to long-term performance, removing incentives for irresponsible and diminishing the ability of responsible politicians to adopt policies that advance the long-run interests of the human race.

### **3. The age of Keynes**

In the 1920s British economist John Maynard Keynes wrote a *Tract on Monetary Reform*, in which he distinguished two different macroeconomic dangers. The first was *deflation*—the possibility of a sharp fall in the price level and in the volume of total spending. The second was *inflation*—the

possibility of a sharp rise in the price level and in the volume of total spending.

Consider the first danger, *deflation*. A fall in the overall level of prices and in the nominal flow of spending, Keynes argued, ought not to affect what is produced or how much is produced: for such “a fluctuation in the measuring-rod of value does not alter in the least the wealth of the world, the needs of the world, or the productive capacity of the world.” However, Keynes went on to argue, such a fluctuation *does* have important and destructive consequences because of the “peculiarities of the existing economic organization of society”: because investors can always refuse to invest and store their wealth in cash, entrepreneurs must always pay a positive nominal interest rate for the capital they need; thus a fall in the price level carries with it very high *ex post* real interest rates that entrepreneurs must pay, leaving them potentially bankrupt.

Because:

the *fact* of falling prices injures entrepreneurs... the *fear* of falling prices causes [entrepreneurs] to protect themselves by curtailing their operations; yet it is upon the aggregate... willingness to run... risk[s], that the activity of production and of employment mainly depends.

Falling prices (and spending) or the fear of falling prices (and spending) are the principal sources of mass unemployment, idle capacity, and destroyed economic wealth. This was written nearly a decade before the nadir of the Great Depression. Yet its relevance to the Great Depression is complete, and the world is a worse place because those making policy in the 1930s did not keep this principle in mind and take steps to avoid deflation.

The second danger, inflation, is in Keynes's view a subtler—although not necessarily a less serious—threat. Inflation redistributes income away from savers who do not have the financial sophistication to invest in equities or indexed financial instruments. Inflation redistributes income away from anyone with a fixed income who has already exercised and used up his or her bargaining power in the market. Inflation redistributes income toward entrepreneurs, and toward those fortunate enough to owe fixed sums. Keynes sees three things wrong with inflation. The first is that it is

“Injustice”: an essentially random redistribution of income and wealth that causes more misery and want to those who lose than it gains happiness for those who win. The second is that of those groups harmed by inflation the one harmed most seriously is the class of *rentiers*: those who earn their income by loaning out their capital, the class of savers. Inflation thus discourages many kinds of saving; Keynes is a strong believer in the power of compound interest in the form of saving to eventually bring the human race to utopia; and inflation tends to delay the accumulation of capital and the process of compound interest.

The third danger that Keynes sees in inflation is the most serious, and shows Keynes at his most prescient. He wrote in 1919 that:

there is no subtler, no surer means of overturning the existing basis of Society than to debauch the currency [through inflation]. The process engages all the hidden forces of economic law on the side of destruction, and does so in a manner which not one man in a million is able to diagnose.

In Keynes’s mind, the first danger was that inflation confiscated wealth *arbitrarily*, thus not only undermining everyone’s belief in their economic security but also providing a powerful object lesson that there was no justice or equity of any sort to be found in the existing distribution of wealth. Moreover, the class that lost the most from inflation was the class of small savers who did not have the financial sophistication to guard against the depreciation of the currency. Such people are usually the firmest supporters of limited governments and pronounced opponents of arbitrary power: after all, they have done well under a constitutional order, and any left or right wing revolutionary regime is not likely to be in their interest.

Keynes concluded in 1919 that the European governments which had resorted and were resorting to inflation were “fast rendering impossible a continuation of the social and economic order of the nineteenth century. But they have no plan for replacing it.” He was right: the confiscation of the wealth of Germany’s upper middle class by the hyperinflation of 1923 is usually listed as a principal cause of the at best lukewarm support offered to the constitutional Weimar Republic in interwar Germany. Through the inflation of the early 1920s, the democratic government of this Weimar

Republic did its natural supporters, the prosperous relatively small-scale savers of Germany in the professional and mercantile classes, a most grievous economic injury by confiscating most of their savings. The social democratic and Christian democratic politicians of the Weimar Republic did lack a plan for replacing the nineteenth century capitalist social and economic order. And in Germany the replacement turned out to be Adolf Hitler.

Which danger was most on Keynes's mind at any particular date depended on which danger was the greatest threat. In the immediate aftermath of World War I and through the mid-1920s, the principal danger was inflation as governments filled the gap between their revenues and spending expanded first by war and then by postwar reconstruction through the printing of money. From 1925 on—after the more-or-less complete restoration of the gold standard, and especially after the beginnings of the Great Depression—*deflation*, mass unemployment, and the fear of falling prices were the great enemy.

In either case the cure was much the same:

The best way to cure... must be to provide that there shall never exist any confident expectation either that prices generally are going to fall or that they are going to rise; and also... that a movement, if it dose occur, will [not] be a big one.

The agent that is to provide this cure is sometimes the central bank (stabilizing price) and sometimes the treasury (stabilizing total spending) so that “whenever something occurred which, left to itself, would create an expectation of a change in the general level of prices, the controlling authority should... set... in motion some factor of a contrary tendency.”

Politicians remember Keynes as a foe of unemployment and deflation, because unemployment and deflation were the principal problems in the times when he had greatest influence. It may be that he did fear unemployment more—he did write that “of the two [inflation and deflation] perhaps deflation is... the worse; because it is worse, in an impoverished world, to provoke unemployment [by allowing deflation] than to disappoint the rentier [by allowing inflation].” But that passage is followed immediately

by:

it is not necessary that we should weigh one evil against the other. It is easier to agree that both are evils to be shunned. The Individualistic Capitalism of to-day, precisely because it entrusts saving to the individual investor and production to the individual employer, *presumes* a stable measuring-rod of value, and cannot be efficient—perhaps cannot survive—without one.

If you want to seek the legacy of Keynes it is in the willingness to accept that *macroeconomic management* is an important task of the government: “the regulation of the standard of value [must] be the subject of *deliberate decision*. We can no longer afford to leave it in the category [of]... matters which are settled by natural causes, or are the resultant of the separate action of many individuals acting independently.”

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#### **4. Has it worked?**

Has it worked? Have governments in the age of Keynes been more successful at moderating the business cycle, and restraining economic catastrophes that would upset the political coalition that supports social democracy?

There are some—weak—signs that there have been improvements in economic knowledge, or improvements in the structural resilience of the economy, that have moderated the destructive impact of the business cycle in the second half of the twentieth century.

Christina Romer has constructed a consistent chronology of business cycles for the past century in the United States. According to her chronology, recessions have become rarer (although not shorter). Compared to the 1916-45 (“interwar”) period, and to a lesser extent compared to the 1886-1915 (“prewar”) period, there has been a reduction in the share of the time that the economy has spent in recession, with falling levels of production.

### Statistics on American Recessions: Duration and Frequency

Period	Fraction of Time in Recession	Average Duration of Recessions	Number of Recessions per Thirty Years
1886-1915	0.22	9.9	8
1916-1945	0.28	12.5	8
1946-1975	0.19	11.2	6
1976-1996	0.12	10.3	4.3

### Average Level and Variability of American Unemployment

Period	Average Unemployment	Standard Deviation of Unemployment
1886-1915	6.6%	2.9%
1916-1945	9.6%	7.2%
1946-1975	4.8%	1.3%
1976-1996	6.8%	1.3%
1946-1996	5.8%	1.6%

The major improvement in performance stems from the fact that the post-World War II era has seen no repetition of the Great Depression. If it is indeed the case that the Great Depression has taught us how to avoid another such, then there has been a vast improvement in economic stability. And even if the Great Depression was unique, there are some signs that the variability of unemployment is lower and the sizes of recessions smaller since World War II than before. But these extra improvements relative to the pre-Great Depression era—if they are true improvements in economic performance, and not just figments of the data—are relatively small, and not much to boast about.

And even the best macroeconomic management is no guarantee that on average the business cycle will produce the levels of employment or of income distribution that you want. Structural policies to level out the income

distribution and maintain a high average level of employment face their own tradeoffs. Structural labor market policies are expensive; if you try to do them on the cheap you wind up with an unfavorable distribution of income, or a high level of employment; if you commit the appropriate level of resources to education and training, to job search assistance and employment subsidies, you will surely hear complaints-sometimes justified-that taxes are too high to sustain growth and investment.

Thus there are a number of rules-of-thumb for economic management: Run a government surplus to keep the government's hunger for resources from draining the pool of resources for society's non-governmental investments. Use "automatic stabilizers"—decreases in tax collections and increases in social welfare spending in recessions-to cushion declines in employment and increases in poverty that occur when financial market shifts trigger depressions. Guarantee the safety and soundness of the credit system as a whole in emergencies, even though it rescues many who made overrash bets and provides some encouragement for future overrash and overspeculative investments. Guarantee not just the domestic but the international credit system. Stabilize prices to the extent that the pursuit of price stability does not endanger more important ends, for price stability is a means to low unemployment, high saving, fast growth, and an equitable distribution of income.

But these remain mere rules of thumb. For the "science" of macroeconomic management has advanced surprisingly little beyond its level in the 1920s. There is little that we could say about how to manage an economy that would surprise those who wrote about economic policy in the aftermath of World War I.