OPINION

Economics for the Long Run

By John B. Taylor

As this election year begins, a lot of people are wondering what we can do to restore America's prosperity and create more jobs. Republican presidential candidates are offering their ideas, and at his State of the Union message on Tuesday President Obama presented his. I believe the fundamental answer is simple: Government policies must adhere more closely to the principles of economic freedom upon which the country was founded.

At their most basic level, these principles are that families, individuals and entrepreneurs must be free to decide what to produce, what to consume, what to buy and sell, and how to help others. Their decisions are to be made within a predictable government policy framework based on the rule of law, with strong incentives derived from the market system, and with a clearly limited role for government.

> Individuals should be free to decide what to produce and consume, and their decisions should be made within a predictable policy framework based on the rule of law.

The history of American economic policy displays major movements between more and less economic freedom, more and less emphasis on rules-based policy in fiscal and monetary affairs, more and less expansive roles for government, more and less reliance on markets and incentives. Each of these swings has had enormous consequences. Taken together, they make for a historical proving ground to determine which policy direction is better for restoring prosperity.

A big move toward more interventionist policies started in the mid-1960s, after more activist Keynesian economists came to town in the Kennedy and Johnson administrations, and it lasted through the 1970s in the Nixon, Ford and Carter administrations. We saw short-term stimulus packages, temporary tax rebates or surcharges, go-stop monetary policy with inflationary overexpansion followed by severe contraction, wage-and-price guidelines and controls. The eventual result was high unemployment, high inflation and slow economic growth.

This was followed by a shift toward more predictable policies and a more limited role for government starting in the Reagan administration and largely continuing into the George H.W. Bush and Clinton administrations. The result was lower unemployment and higher economic growth with long expansions and few recessions.

More recently—beginning during the George W. Bush administration but really taking wings in the current Obama administration—policy has returned toward more and more government intervention, with results we are all experiencing.

How to move the country back toward the policies that sustain economic freedom and prosperity? To start, much can be learned from the stories of the politicians and economic officials who got us in and out of these messes, and remembering that the cast is bipartisan. Most pertinent to our current predicament is the story of how we got out of the economic mess of the late 1970s.

It's difficult to recall now the seriousness of the U.S. economic slump at that time. Unemployment was high and persistent. Inflation had increased past the creeping stage to a trot. Confidence in U.S. economic leadership was plunging at home and abroad.

That changed when Ronald Reagan became president in 1981. Temporary, short-term Keynesian actions and interventions were out. Stable, permanent policy was in. Reagan proposed and Congress passed critical long-term reforms, especially across-the-board tax rate reductions.

The president was a firm believer in economic freedom, an avid reader and follower of economists like Milton Friedman and Friedrich Hayek. Between the time he failed to unseat President Gerald Ford in the 1976 Republican primaries and his announcement to run again in 1980, Reagan gave innumerable radio addresses putting forth his principles. He used down-home stories of economic freedom that he could tell in three minutes or less. There were no ghost writers—he wrote his stories in long hand on lined yellow paper as he traveled around the country. The failed policies of the 1970s made Reagan's case appealing across the political spectrum. He based his winning election campaign on these principles.

Reagan appointed a large number of economic officials who also were firmly committed to moving away from interventionist policies. No members of the original Council of Economic Advisers under Reagan had come from the Keynesian school of thought, and most of them during the Reagan administrations were influenced by Milton Friedman.

In addition, the president appointed a group of outside economic advisers—originally including George Shultz, Milton Friedman, Alan Greenspan, Arthur Laffer, William Simon and Thomas Sowell—who helped him and others in the administration implement policies to move the country toward economic freedom and then stay the course.

As an example of Reagan's firm commitment to principle, consider monetary policy. When he became president, Federal Reserve Chairman Paul Volcker, a Democrat appointed by President Carter, was determined to reduce inflation and end the go-stop interventions of the 1970s. That meant temporarily high interest rates, which contract the economy. One might have expected Reagan to pressure the Fed to lower interest rates to give a short-term boost to the economy. He did not, despite the political costs. In comparison with the political pressure put on Fed Chairman William McChesney Martin by the Johnson administration and on Arthur Burns by the Nixon administration to follow easy money policies, Reagan's decision to support Mr. Volcker was remarkable.

The president's economic strategy was ready to go as soon as the votes were counted in November 1980. That same month, George Shultz, along with many of the economists who had worked in the campaign, wrote an extraordinary memo to Reagan entitled "Economic Strategy for the Reagan Administration." It began with a call for action: "Sharp change in present economic policy is an absolute necessity. The problems . . . an almost endless litany of economic ills, large and small, are severe. But they are not intractable. Having been produced by government policy, they can be redressed by a change in policy. . . . The need for a long-term point of view is essential to allow for the time, the coherence and the predictability so necessary for success."

That predictable, long-term view continued well beyond the Reagan presidency, but it is no longer with us. The clear lesson is to find and select those leaders, regardless of political party, who along with their advisers are most firmly committed to the principles of economic freedom and who know how to implement and maintain them.

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