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The Macroeconomic Legacy of Reaganomics

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My objectives in this article are twofold. First, I want to examine in a broad sense the macroeconomic legacy of the Reagan administration. This has three dimensions—one philosophical, one theoretical, and one relating to an array of practical problems left behind as this administration fades into history. Second, I want to look ahead to analyze some of the important social and economic objectives that ought to be on the agenda for the rest of this century. These remarks are an exercise in political economy, combining both analysis and advocacy.

The Philosophical Legacy of Ronald Reagan

Recent scandals involving Iran may have put the administration in disarray and reduced its effectiveness, but nonetheless, the administration is leaving behind an attitude of mind that is of major philosophical importance. This is the belief that government has no real capability to solve any of our major problems. It is a theme that the administration and its conservative supporters have been relentlessly drumming into the public consciousness for the past six years. As the president has said again and again, "Government is the problem, not the solution to the problem." This may be, perhaps, the most enduring achievement

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of this administration, assuming that the American people continue to adhere to this view after Mr. Reagan has left office.

The foregoing is the rub. How deep does this attitude go? Is it something that is entirely personal, unlikely to survive the Reagan presidency? We simply don't know at this point. Liberals hope that the "Reagan Revolution" will turn out to be mostly empty rhetoric, a momentary abberation that will become nothing but a painful memory once Reagan has left the White House. But we cannot be sure of this. In our own profession, the powerful resurgence of neoclassical economics, with its faith in rationality and market solutions for almost any problem, continues. Neoclassical economics dominates graduate education in this country, controls the mainline journals, and pays scant attention to any criticisms of the unrealism and irrelevancy of its basic paradigm. This is true even though some of the most prestigious Nobel laureates of the profession have been scathing in their critique of the neoclassical approach.[1] In addition we have the evidence of practical politics. The Democrats, presumably the custodians of the liberal faith in positive and constructive government, have not challenged Reagan on his basic point about government. All too often they have tacitly, if not explicitly, tended to agree with him, taking a "me-too" stance much as the Republicans did earlier in the post World War II era when the Democrats were setting the agenda. Robert Lekachman recently expressed such fears when he described front-runner Gary Hart as being typical of a number of leading "neoliberal" Democratic politicians who have, in fact, bought the conservative line that market solutions are always inherently better than "bureaucratic"—that is, government—solutions.[2] For institutionalism there is no more urgent task than to attack this philosophical legacy of Reaganomics, both at the level of abstract economic theory and at the level of practical political action.

The Theoretical Legacy of the Reagan Presidency

In juxtaposition to the philosophical dimension of the macroeconomic legacy of Reaganomics, we have a theoretical dimension that bears importantly on the future of macroeconomic analysis and policy. Paradoxically, the picture here from a liberal perspective is much brighter. This is because the Reagan years have provided us with an interesting economic "experiment" of the kind that John Stuart Mill said the social sciences must depend upon and which are cast up by the accidents of history.[3] As a matter of fact, two key propositions of theory have been "tested" by Reaganomics, and both failed the test! These propositions are, first, supply-side economics, and, second, monetarism. Let us examine the argument that both have been tested by Millsian "experiments" cast up during the Reagan years.

The colossal theoretical failure of Reaganomics is supply-side economics, the underlying rationale for the massive tax cuts of 1981. Drawing directly upon the unproven ideas of Arthur Laffer, the supply-siders led, by Jack Kemp in the Congress, George Gilder, the movement's intellectual guru, and Paul Craig Roberts within the administration, persuaded President Reagan that drastic cuts in the personal and corporate income taxes would work economic miracles. Tax cuts were supposed to unleash a torrent of productive effort, resulting from higher saving, greater work effort, and more investment. Productivity would come out of its slump, and through the magic of the Laffer curve the federal deficit would disappear by 1986. As we know, none of this happened. Tight money, also a part of the supply-sider's prescription, put the economy into a recession, the worst since the Great Depression of the 1930s. The recovery, when it began in late 1982, was Keynesian-based, brought about by massive federal deficits, rising military outlays, and reductions in the interest rates engineered by the Fed.[4] *Sic transit* supply-side economics!

The failure of monetarism in the light of Millsian experiments is more subtle but nonetheless real. There are two aspects to this failure. The first involves the long-standing argument of the monetarists that inflation can be ended without the pain of a recession if an administration let it be known that it was unyielding in its commitment to reining in the money supply. The effect of this was supposed to be a dramatic lowering of inflationary expectations, followed by a slowdown in the inflation rate. This would happen before the economy fell into a recession.[5] Unfortunately, the economy failed to follow this scenario. The Reagan administration brought the inflation rate crashing down, but only after the economy was plunged into a deep recession during which the unemployment rate reached a postwar high of over 10 percent. It is only within the last couple of months that the rate dropped below 7 percent, the level it was when Reagan assumed the presidency in 1981.

The second aspect of monetarism's failure is more recent. The most fundamental tenet of monetarism is the close connection between money and the price level. For monetarists, inflation is everywhere and always a monetary phenomenon, yet events of the last few years have seriously undermined this argument. Since late 1984 the Fed has been accelerating the growth of the money supply—M1 has risen in its annual rate of growth from 6.0 percent in 1984 to 16.5 percent last year. In the latest month for which data are available, M1 grew at an annual rate of 18.8 percent. Yet the inflation rate has fallen drastically, going from 8.9 percent in 1981 to 1.1 percent last year.[6] Even Beryl Sprinkle, strong monetarist and now Chairman of the Council of Economic Advisors, admits monetary theory has gone awry.[7] Velocity has dropped, but the falloff has been nowhere near great enough to offset the increase in money in circulation.[8] Where has all the new money gone? No one knows for sure, but a good bet is that a sizeable proportion has gone to finance the speculative boom on the stock market, not to mention the wave of corporate mergers, buyouts, and take-overs.

The Legacy of Troublesome Problems

The third dimension of Reagan's macroeconomic legacy is an array of problems, no one of which in isolation is necessarily critical, but when taken together they add up to a difficult and dangerous situation. We are not immune from a major collapse. *Washington Post* columnist David Broder succinctly summarized these problems not long ago as follows:

> The slowdown in *real* economic growth from four percent in the 1960s to barely half that in the 1980s; the decline in investment and productivity; the slump in real earnings from a 1974 peak to below the level of 1963; the upward trend in unemployment; the alarming growth of America's domestic and international debt; the real threat that the competing nations are outstripping us in education and technological ingenuity.

I will discuss Reagan's legacy of troublesome economic problems under four headings: the deficit and the public debt; the foreign trade deficit; the military budget; and the distribution of income and wealth. This will provide the backdrop for the final section of this article, where I shall turn to the question of the social and economic agenda for the balance of this century.

The Deficit and the Public Debt

Overshadowing all else and first in the minds of many people is the deficit and public debt flowing from the deficit. In the last six fiscal years the Reagan deficit has risen from $73.9 billion—that was in fiscal 1981—to a level of $238 billion in the fiscal year just ended. In this same period the federal debt more than doubled, going from $1,004 billion in the first year of the period to $2,133 billion at the present. This is a 110 percent increase, a staggering figure by any means of calculation.[9]

Now some of the consequences of this are readily apparent. First, the ratio of debt to the gross national product, which had been trending downward generally since World War II, has risen from a ratio of 33.5 percent in 1980 to 50.7 percent in 1986.[10] This means that the debt is growing faster than our real output. Economists like to remind us that there are dangers in trying to draw analogies between what a national government does or can do and what a household does. But in this case the analogy may fit better than some people think. Because an increasing portion of our national debt is held by foreigners, we are in a situation like the householder who continually spends more than he takes in. Ultimately the householder is going to be confronted with a debt burden beyond his or her capability to manage. We may not be exactly in that position as a nation, but there are similarities.

A second matter of serious concern is interest on the debt. The debt has to be serviced, and this means paying interest to those who own the debt. This is part of the federal budget and, like other expenditures, has to be covered ultimately by taxation. The interest on the debt in 1986 was $136 billion. It has gone up from 8.7 percent of federal spending in 1980 to 16.5 percent in 1986.[11] Interest on the federal debt is a transfer payment. Citizens at large are taxed to finance the expenditure, which is directed toward a particular group. The people on the receiving end of this expenditure are those who hold the bonds of the federal government, most of whom are wealthy individuals at the top of the income scale. Transfer spending associated with the debt is regressive. This is alarming because the distribution of income in this country has worsened in the last few years. Interest on the debt contributes to this worsening.

A third point is that the deficit is generally blamed for the strong influx of foreign capital into the United States. A large deficit means the federal government has to borrow, something that has kept interest rates in this country higher than otherwise, and higher than they are abroad. As a consequence, foreigners turn to this country to invest their funds. To do this they must obtain dollars, and this is what drives up the foreign exchange value of the dollar. This happened in the past, although it is not happening now because the foreign exchange value of the dollar has gone down. Nevertheless the increase in the early 1980s and late 1970s in the foreign exchange value of the dollar made imports cheap and our exports expensive. This brings us to the foreign trade deficit, the second major problem area.

The Trade Deficit

As just indicated, the merchandise trade deficit is tied in with the federal deficit because the latter drives up interest rates which, in turn, attract foreign capital, driving up the foreign exchange value of the U.S. dollar and making exports expensive and imports cheap. As a consequence of these developments, the merchandise trade deficit has gone from $24.2 billion in 1980 to $169.8 billion in 1986.[12] One result has been the devastation of major parts of the domestic economy, particularly in the goods-producing areas such as agriculture and manufacturing.

The ultimate consequence is that the United States has gone from being an international creditor to an international debtor in the space of a few years. Over $140 billion in international assets have been dissipated, having been used mostly to finance a domestic consumption boom. Before World War I the United States was a debtor nation. Then proceeds from foreign lending were used to develop the nation's infrastructure, namely the railroads, the water systems, the power systems, and other resources that make up our social capital. We were, in effect, using foreign capital to help build our capacity to produce. This helped to repay the loans later. Now, however, we have used the proceeds from foreign lending to finance consumption and an overblown military budget.

Foreign debts not only have to be serviced but someday repaid. Servicing means paying interest to foreigners, and repayment means liquidation of the debt. Normally, a country pays its way internationally when it borrows by being able ultimately to export more than it imports. We are able to import more than we export because foreigners remain willing to take U.S. dollars—paper money—because they want to invest in securities and real capital assets in this country. There is no real assurance that this will continue indefinitely. Thus, someday we are going to have to turn things around and export more than we import, which means a reduction in the rate of growth of our real standard of living. When we export more than we import we are going to have less available to consume at home. That is what faces us in the future, but it is uncertain how the nation will achieve this.

The Military Budget

The third element in the Reagan legacy of problems is the inflated, overblown military budget. In *real* (1982) dollars this administration has spent $1,287 billion in the last six years. The ratio of military spending to the gross national product has gone from 5.5 percent in 1980 to 6.6 percent in 1986.[13] We've had a major military buildup, but one that has been essentially haphazard because money was spent for nearly any "high tech" military system, irrespective of its effectiveness. There is good reason to question whether we have improved significantly our overall military posture from what it was five or six years ago. More hardware is available but there is serious doubt about its effectiveness.

What are the consequences of this vast expansion in military spending? First, there is its contribution to the deficit. The Reagan administration has consistently refused to raise taxes to finance military spending. It was argued that it was possible to get out of the federal budget enough money from other programs to finance the military increases. This has not been possible. Still, the administration consistently refuses to consider increasing taxes to pay for what it argues we need in the way of military protection. Second, there has been a continued drain on productivity because increasing amounts of our skilled scientific and engineering resources have been absorbed by military spending. Contrary to popular opinion, there is very little if any civilian carryover of benefits from this.[14] The Japanese and West Germans, not burdened by this excessive military spending, have forged ahead in the international economy. They are the technical leaders on the world economic stage, producing more and more of the goods that enter into international trade. We need only to look at the things we are importing today to see that is the case. Increasingly the goods we consume are made abroad. The decision to devote so much of our resources to the military budget contributes to this.

The Distribution of Income and Wealth

The fourth feature of the Reagan legacy of economic problems centers on a worsening situation with respect to both domestic income and wealth. The deteriorating situation in income distribution is shown in Table 1. This table contains data on the distribution of income between four major classes for selected years between 1970 and 1985. In a nut-

Table 1. ***Income Distribution: 1970–1985* (in percent)***

Income Category	*1970*	*1975*	*1980*	*1985*
Above $50,000 (affluent and rich)	13.0%	13.9%	15.1%	18.3%
$15,000 to $49,999 (middle class)	65.1%	63.5%	61.7%	58.2%
$10,000 to $14,999 (near poor)	9.9%	10.4%	10.4%	10.2%
Below $10,000 (poor)	12.0%	12.2%	12.8%	13.3%

*Family Income in Constant 1985 Dollars

SOURCE: U.S. Department of Commerce, *Current Population Reports.*

shell, the rich have been getting richer, the poor have been getting poorer, and there has been a squeeze on the middle class. The most significant statistic in this table is the one showing what has happened to the middle class. In 1970, middle class families claimed 65.1 percent of the total income. By 1985, however, this percentage had fallen to 58.2 percent, although in the same period the share going to those at the very top, the families above $50,000, went from 13.0 to 18.3 percent. In this same period, the combined proportion of the near-poor and the poor increased slightly, going from 21.9 percent in 1970 to 23.5 percent in 1985. What this shows, given the decline in the relative importance of the middle class, is that more and more middle-class people have been forced into the ranks of the poor or the near-poor, although some, of course, have moved into the ranks of rich. The Reagan 1981 tax cuts, plus cuts in social spending, contributed to this development.

What is to be Done?

It is not enough just to analyze; as John H. Williams once said, "Economic theorizing seems to me pointless unless it is aimed at what to do."[15] The answers to the question are found on the philosophical plane and on the plane of practical policy.

The appropriate response to the Reagan administration's anti-government philosophy is to look at the record. Specifically, we need to examine the record in the post World War II period of activist versus non-activist administrations. An "activist" administration is one concerned with trying to influence the level of economic activity with respect to employment, the price level, and economic growth. This is not a perfect definition, but it is workable. After World War II the activist administrations were those of Truman, Kennedy-Johnson, and Carter, while the "non-activist" administrations were those of Eisenhower, Nixon-Ford, and Reagan. There are, of course, shades of difference between all these administrations and the classification is somewhat artificial, but, on the whole, the first three administrations named were much more inclined to intervene and manage the economy than the latter three. If we exclude the Korean and Vietnam wars, there were, from 1948 onward, twelve years of activist government and nineteen years of nonactivist government. Before proceeding to examine the statistical evidence on the performance of activist versus nonactivist administrations, a *caveat* is in order. Statistics alone are not sufficient to overturn Reagan's philosophic legacy that minimal government is always best, but unless the case for a return to activist government has a strong factual underpinning, little can be done. Fortunately, the empirical evidence is there.

Table 2 contains the statistical data that makes the case for a return to an activist government. For the period 1940–1986 (Korean and Vietnam wars excluded) the table contains ten indicators of economic performance. For one indicator, the poverty rate, there are not enough data available to make a legitimate comparison. But for the other nine indicators there is adequate information on the performance of all six administrations in the periods indicated. As the table shows, activist governments had a superior performance for seven of the indicators: these were the *real* growth rate, the unemployment rate, the rate of productivity growth, the rate of growth in industrial production, the percentage increase in jobs, the proportion of industrial capacity used and, interestingly enough, deficits. The nonactivist administrations recorded a superior economic performance for only two indicators, namely, the inflation rate and the rate of growth of *real* hourly earnings. The conclusion is that, in almost every instance, an activist government led to a superior economic performance.

Turning from the philosophical issue of the need for a return to an activist government, the next question is how is this to be done? This involves a number of practical policy actions. The first of these is the necessity to bring the deficit under control. Despite the Keynesian impact of the deficit as a stimulus to aggregate demand, and therefore a factor in the economy's current expansion, the deficit remains as a basic psychological obstacle to any return to an activist government. So it must be brought under control. The difficult question is how? Is it possible to bring the deficit under control?

From an economic standpoint the answer is deceptively simple, but given the politics of the situation the answer is actually exceedingly complex. There are only two possibilities. One is to cut back the overblown military budget. Social spending to date has been cut to the bone in this economy; there is little possibility for any further cuts here. The notion that there is excessive waste and fat in the government has proved to be an illusion. The Reagan administration, more committed to this notion than any in history, has simply not been able to find it. A cutback in military spending must rest upon a serious reevaluation of our genuine security needs. The Reagan administration has taken the stance that anything anywhere in this world that happens of an adverse nature is our concern, both militarily and politically. Such a stance is untenable. We do not have the resources to spread ourselves so thinly around the globe. Therefore, we must reevaluate our national security position and come to understand our long-term interests. They lie, for the most part, in western Europe, Japan, Australia and New Zealand, and, perhaps, some parts of the Middle East. Paring back the mili-

Table 2. ***Activist and Non-Activist Administrations in the Post World War II Era: 1948–1986****

	Real GNP Growth	*Inflation Rate (in percent)*	*Unemployment Rate (in percent)*	*Rate of Productivity Growth*	*Rate of Growth Industrial Production*	*Percent Increase in Jobs*	*Industrial Capacity Use (percent)*	*Deficit/Surplus (in billions)*	*Rate of Growth Real Hourly Earnings*	*Poverty Rate (in percent)*
Activist Administrations										
Truman: 1948–1950	4.1	2.9	5.0	4.6	3.8	1.1	79.8	$ 5.0	2.6	NA
Kennedy-Johnson: 1961–1965	4.6	1.3	5.5	3.7	6.3	1.0	83.5	$ −2.1	1.8	19.7
Carter: 1977–1980	3.1	10.4	6.5	0.3	4.1	2.9	82.4	$ −38.2	−1.4	11.9
Average (twelve years)	4.0 **	4.7	5.7 **	2.8 **	5.0 **	1.8 **	82.2 **	$ −12.4 **	0.9	NA —
Non-Activist Administrations										
Eisenhower: 1954–1960	2.2	1.5	5.2	2.3	3.0	0.9	81.0	$ −0.3	2.5	NA
Nixon-Ford: 1971–1976	2.7	6.6	6.4	1.9	3.0	2.0	79.9	$ −29.8	0.6	11.8
Reagan: 1981–1986	2.4	4.3 **	8.1	1.2	2.6	1.7	77.2	$−191.1	0.0 **	14.7 —
Average (nineteen years)	2.4	4.1	6.4	1.8	3.0	1.5	80.0	$ −63.8	1.1	NA

*Korean and Vietnam War years excluded
**Superior Performance.

SOURCE: *Economic Report of the President,* 1987.

tary budget, overinflated with unproductive, uneconomic spending is the only route through which we can achieve significant reductions in future federal spending.

Action is also needed in the area of taxation. If the budget is to be brought under control, there is no alternative to an increase in taxes. It is a disgrace that a nation as wealthy as ours refuses to pay for what it wants, including spending for defense and spending for social programs. There is no alternative to higher taxes because even with cutbacks in military spending, the deficit is so large that it cannot be handled by that means alone. So if we want to get the budget deficit under control, then we are going to need an increase in taxes. This will not be easy to do, given the fact that we have just gone through a wrenching exercise in tax reform.

Getting the budget deficit under control is an extremely delicate economic problem, because *any* action we take in either cutting back on military spending or increasing taxes is going to be deflationary. Past history demonstrates that this economy is highly sensitive to deflationary measures. Thus, it will be easy, if we are not extremely skillful, to plunge the economy into a recession as we try to bring the budget deficit under control. Nevertheless, it must be done. If we do not, there is no possibility of launching programs that involve a restoration of activist government in Washington.

Along with efforts to bring the deficit under control, we must simultaneously adopt a full employment policy. A full employment policy means that we have to take action to make it possible for all citizens who want to work to secure suitable work at reasonable wages. A careful analysis of the U.S. economy shows that employment, inequality, and poverty are all closely related. Therefore, in the immediate future, the most effective way to attack simultaneously both excessive poverty and excessive inequality in the distribution of income is through a policy of full employment. Lack of jobs with adequate pay is one of the major reasons for the persistence of poverty, as well as the increase of poverty in recent years. In the 1980s, for example, the poverty index, which measures the percentage of people living below the poverty line, rose sharply, jumping from 11.7 percent in 1979 to a peak of 15.2 percent in 1983 and then dropping back slightly to 14.4 percent in 1984 as we recovered from the 1981–1982 recession. Full employment is also one of the quickest and least painful ways to lessen income inequality in the economy. The degree of inequality of wealth and income in this country is a long-term problem, one that can be dealt with only by basic structural changes. A start in this direction can be taken by having full employment. The reason for this, as has been shown by a number of economists, is that the income distribution pattern for fully employed white males is far less unequal than the overall distribution of family income. So if we had a full employment policy that actually put people to work, there undoubtedly would be less inequality in the actual distribution of family income.

This country has not had full employment since the brief experiment with such a goal during the Kennedy-Johnson years. With the advent of a non-activist conservative administration in 1969, full employment was dropped from the national agenda, even though President Nixon professed for a time that he was a Keynesian. Economists must share some of the blame for the abandonment of full employment as an important item on the national agenda because of their fascination with the doctrine of the "natural" rate of unemployment. This concept, invented by Milton Friedman, permitted economists to take a cool and detached view toward unemployment rates that earlier would have been a source of great concern.

It is not going to be as easy now as it once was to achieve full employment. One reason for this is that the link between output and jobs is not so close as it was, partly because of labor-saving technological changes. Automation, for example, has led to significant job losses in the goods-producing sector. Therefore, we have some difficult problems to cope with. One possible solution would be to recreate some of the job agencies of the 1930s depression. For example, we might reestablish something like the old Civilian Conservation Corps (the CCC) to provide an introduction into the labor market for young people who otherwise may be idle. We ought to reintroduce agencies like the Public Works Administration (PWA), which was oriented toward building the infrastructure of the nation. The more work-oriented Works Progress Administration (WPA) also ought to be considered. We also had in the 1930s the National Youth Administration (NYA), which primarily provided jobs for students while they were going to college. All of these depression-era agencies were successful in giving employment at approximately the minimum wage to large numbers of people. This was better than having them on the relief rolls. Further, these projects left a legacy of *real* things that we are still enjoying.

With full employment, we must have an incomes policy. An incomes policy involves creating arrangements whereby when employment and output rise, increases in money wages, rents, profits, and interest rates remain within the bounds set by productivity increases. This is essential to prevent increases in unit costs so that we do not have a resurgence of inflation as we get back to full employment. The inflation rate is low, but the source of that, in part, is a high rate of unemployment.

Because of market power—the ability of producers to influence prices —and because corporations price on a mark-up basis, there is strong pressure for prices to go up well before we reach full employment. Therefore, we need an incomes policy to control prices so that as we get toward full employment, we will not have a resumption of inflation, as happened in the late 1960s. In the early 1960s the Kennedy-Johnson adminstration designed a workable incomes policy, the wage-price guideposts. Unfortunately, this policy had no teeth in it. It depended upon exhortation to the trade unions and to the business community by the president. This is why it was known as "jawboning." The policy collapsed when the economy began to heat up under the impact of Vietnam war spending; money wages began to run ahead of productivity gains. The result was a built-in inflationary wage-price spiral that continued all through the 1970s. The latter was augmented significantly by the two rounds of price hikes for petroleum imposed on the world economy by OPEC, the first in 1973, and the second in 1979. We do not now have an incomes policy. However, an incomes policy is a must if we are going to have a full employment economy and if we are going to try and get the unemployment rate down to at least 4, or even 3 percent.

It is not well known to the general public, but legislation already exists to do this in the Balanced Growth and Employment Act of 1979—the Humphrey-Hawkins Bill—which in effect mandated an employment policy that would get the unemployment rate down for the typical working male who heads a household to 3 percent, and to 4 percent for every other employed person. This legislation has a big loophole in it, permitting the president to say, in effect, that conditions are such that we cannot achieve full employment, allowing it, therefore, to be postponed. Beginning with Carter and continuing through Reagan, presidents have simply ignored this goal, saying it is not attainable. We should not allow such inaction to continue.

Looking to the Long Run

The matters discussed to this point are essentially of an immediate and short-term character, having to do with the things we must do to get back to an activist governmental stance as soon as possible. In the longer run, which is not easily defined, we must look for more fundamental changes in the nation's economic system. First, we have to examine the possibility of having some form of public employment as a permanent fixture of the economy. What we have done in the post-war period is resort to what the late Joan Robinson called "military Keynesianism." One of the developments Keynes saw in advanced capitalistic economies was a tendency toward "secular stagnation," a condition of slow growth and high unemployment. Private spending would not be sufficient most of the time to absorb into use all of the nation's productive capacity. So the economy tends to limp along at something less than full employment. The truth in this view lies in the fact that throughout the post-war period we have never had consistent full employment—that is, only 4 percent of the labor force without jobs—except during the periods of the Vietnam and Korean wars. This has been true despite massive military expenditures. The point of Joan Robinson's concept of "military Keynesianism" is that we have been willing to fill in the gap, one that began in the 1950s, with military spending, not with other, more constructive forms of public spending. Military spending has played the role in the post-war period that programs like the WPA and the PWA played in the 1930s. Military spending has been a gigantic work effort designed to bail out large corporations and provide jobs for many people. "Star Wars," the pipedream of President Reagan, is simply the latest episode in this ongoing saga of spending public money on the military because we are unwilling to do other things. This has to change. We must recognize that long-term public employment must be a permanent feature of the economy.

The second matter that needs our attention in the long run is the distribution of income and wealth. In *The General Theory,* Keynes said that the two major problems of modern capitalism were, first, its inability to provide full employment for its people all the time and, second, the extremes of inequality in the distribution of income and wealth. We are just barely beginning to look at the latter, to recognize there may be a chronic problem. The growing awareness, for example, that there is a squeeze on the middle class, and that the number of persons at both the upper and the lower ends of the income scale are growing reflects this. The squeeze on the middle class has finally aroused our awareness about what is happening to the distribution of income and wealth. We cannot continue to ignore this issue because it has a direct bearing on our achieving sustained full employment without inflation. There has to be a rough consensus on the part of the general public that the distribution of income—that is, on the share of income going to wage-earners and non-wage-earners—is, in some sense, fair. In the absence of any such consensus, of feeling of fairness, labor and management pit themselves against each other in a struggle for a bigger share of the income pie. This is what happened in the 1970s after the collapse of the incomes policy devised earlier by the Kennedy-Johnson administration. British economist Thomas Balogh suggests that we need a new social contract in Western societies, by which he means a sort of generalized consensus on the distribution of income between wage and non-wage income. It does not have to be precise but there has to be the belief that the distribution is fair.

This brings me to my final point: the need for a new understanding, for a social contract or consensus on income distribution, that will force us to confront the fact of power in economic relationships. Economic or market power has to do with the ability of the participants in market transactions to control the outcome, to influence the prices or the wages or the income that they get. Power is everywhere present in the economy. Power is just as ubiquitous as is competition, although the standard economic textbooks rarely mention it, even though they have much to say about competition. What this means is that we have to look at the entire institutional structure through which power manifests itself and works. We are not able to eliminate power from society, any more than we can eliminate competition. But the problem is to recognize how power works, to try and understand when and how it is socially beneficial and when and how it is socially adverse. We must try to make the situations and institutions involving power work to benefit all people.

The matters just discussed are tasks for the long term. They will not be easy to accomplish; they represent some of the ways in which American capitalism must be transformed in the decades that lie ahead. Capitalism, like democracy, is never a finished product. We live in a society characterized by an ongoing evolutionary process involving both the economy and our political society. There is nothing wrong or novel in this. It is to be welcomed because it means we are open to change and improvement; this is something we should cherish and protect.

Notes

1. See, for example, Wassily Leontief's 1970 AEA Presidential Address (*American Economic Review* 61 (March 1971): 1–7, or the interview with Herbert A. Simon, *Challenge* 29 (November/December 1986): 18–25.
2. See interview with Robert Lekachman on his new book, *Visions and Nightmares, America After Reagan,* in *Challenge* 30 (March/April 1987): 34–44.
3. John Stuart Mill, *Essay on Some Unsettled Questions of Political Economy* (London: Longmans, Green, 1877), p. 147.
4. Wallace C. Peterson and Paul Estensen, "The Recovery: Supply-Side or Keynesian?" *Journal of Post Keynesian Economics* 7 (Summer 1985). The discount rate dropped from 12 percent in mid-1982 to 5.5 percent at the end of 1986.
5. Thomas Mayer, *The Structure of Monetarism,* (New York: W.W. Norton & Company, 1978).

6. *Current Economic Indicators,* February 1987, pp. 24, 30.
7. *The New York Times,* 3 July 1986.
8. Between 1980 and 1986, the money supply, as measured by M1, increased by 76 percent, but income velocity fell by only 13 percent.
9. *Current Economic Indicators,* February 1987, p. 2.
10. Ibid., pp. 1, 32.
11. Ibid., p. 34.
12. Ibid., p. 35.
13. Ibid., p. 1.
14. Ann Markusen, "The Militarized Economy," *World Policy Journal* 3 (Autumn 1986): 495–576.
15. John H. Williams, "An Economist's Confession," *American Economic Review* 62 (March 1952): 1–12, at p. 10.