Most Americans had a great surge of hope in 1980 when Ronald Reagan was elected president of the United States. Voters saw it as confirmation that “The Tide is Turning,” as we labeled the final chapter of our earlier book, *Free to Choose*. Ever since the New Deal, the United States had been moving in the direction of a bigger and a more intrusive government. For the first time, a man had been elected president not because he was saying what the people wanted to hear, but because the people wanted to hear what he was saying. There is an enormous difference between those two positions. Every earlier president in my lifetime was elected because he watched the polls and said what the people wanted to hear. Ronald Reagan was the first one who kept on saying the same thing for thirty years and finally it became what the people wanted to hear. That is what gave us great hope in 1980, hope that we really were going to be successful in cutting down the size of government and making for a lesser degree of interference in our lives.

To begin with, it looked as if we were getting great success. One of the first achievements of the new administration was in the energy field: the elimination of both the price ceiling on oil and the so-called entitlement program, which was a monstrous program in every respect. Opponents of a free market all threw up their hands and said, “Oh my God, the price of gasoline and oil is going to shoot through the sky.” Friends of a free market could have told them, and did, that the opposite would happen; the price came down, it didn’t go up.

The president similarly had great success with Congress, which passed a series of tax cuts not as large as he initially asked for, but substantial. Furthermore, Congress accepted the idea of indexing the tax system, and cut the top rate of personal income tax from 75 to 50 percent. A number of laws were
passed that supposedly were going to cut down the level of government spending. The flood of regulations that had been pouring out of the Carter administration was reduced to a trickle, and a few were even eliminated.

So for a while everything seemed fine. But then it all stalled. There have been no further gains since then. On the contrary, the level of taxes in the United States has not gone down. Taxes as a percentage of national income has stayed roughly the same or slightly increased. And more important yet, total government spending as a fraction of income has continued the upward march that has characterized it ever since the New Deal in the 1930s.

Even in the area of regulation there has been some backsliding, with the re-imposition of some regulations and the creation of others by governmental agencies. Why has this happened? What has gone wrong? Why has progress seemed to be so slow? These are the questions my wife and I discuss in our forthcoming book entitled, like this article, *Tyranny of the Status Quo.*

One way of approaching an explanation is by using a political generalization of very long standing and one that is vital to understanding what happens in government. A new administration, dedicated to making major change, has about six to nine months to do so. That’s the honeymoon period. Once that period is over, the tyranny of the status quo asserts itself. The defeated forces regroup. The opponents of the initial measures find their voices and reorganize. And from there on, little gets accomplished.

The Franklin Delano Roosevelt administration is a good example of this political generalization. Roosevelt came into office in 1933 at a time, of course, of enormous crisis and catastrophe in the country. Recall the famous special one-hundred-day session of Congress. In that session, one New Deal agency after another was established: the NRA, the AAA, the PWA, the WPA. Take any three initials you can think of and they’re in there—the “alphabet soup” of government agencies. After this initial spurt, the Supreme Court declared the NRA and the AAA unconstitutional, and they had to be disbanded. Roosevelt tried to pack the Supreme Court by adding to the number of judges, but the overwhelmingly democratic Congress turned him down. FDR became a victim of the tyranny of the status quo. And so it was with President Reagan. The visible changes that occurred in the early months
of the Reagan administration are continuing to work their effects and have changed the atmosphere within which discussion goes on. But very few noteworthy changes have been visible thereafter.

Other more recent examples include new heads of states and new administrations elected in Britain, France, and Germany. Conservative Margaret Thatcher replaced Jim Callaghan of the Labor Party. In France, Socialist François Mitterrand replaced Gaullist Giscard d’Estaing. In Germany, Christian Democrat Helmut Kohl replaced Social Democrat Helmut Schmidt. Each case illustrates the political generalization previously mentioned. In the first six to nine months in which Margaret Thatcher was in office, she eliminated exchange controls that had been in operation for forty years, cut the top rate of the personal income tax from approximately 90 to 60 percent, and privatized the trucking industry—some very significant changes. But once that initial period was over, there were no further changes and she, like Reagan, found that total government spending which she had vowed to cut continued to increase as a fraction of income. Taxes, too, went up as a fraction of income.

François Mitterrand shows that this generalization is no respecter of ideology. A Socialist, in the first six or nine months of office he accomplished a great deal. He nationalized the banking industry, imposed heavier taxes, raised minimum wages, and imposed price and wage control over a variety of areas—changes that free market advocates regard as very bad, but changes that showed the ability of a new administration to make an impact. But then he became stymied even worse than Thatcher or Reagan. Not only did he fail to get any new measures through the French parliament, but reality forced him to take a U-turn much sharper than anything that had occurred in either Britain or the United States. The policies Mitterrand has had to adopt in the past two years are more like those of Margaret Thatcher and Ronald Reagan than of Karl Marx or John Maynard Keynes. Three devaluations of the French franc within two years were a very clear indication of the failure of his policies. Economic reality cannot be neglected. Mitterrand was going against the basic forces of the economy, whereas Thatcher and Reagan were going along with them. As a result, the check to his policies was much greater than the check to theirs.
Moreover, Thatcher and Reagan were supported by a change in public opinion. Mitterrand was not. Despite very high unemployment in Britain, plus a severe recession, Margaret Thatcher was reelected, and reelected by an enormous parliamentary majority.

If my generalization about what leaders can accomplish in the initial period of office is accepted, Margaret Thatcher has another opportunity. In the next six or nine months she will be able to make major steps forward if she takes advantage of her opportunities. Once again there will be a honeymoon period.

Like Margaret Thatcher, Ronald Reagan may have another opportunity if he decides to run for reelection, which seems highly likely, and if he is reelected, which seems less likely. He, too, will have another opportunity to make major changes that will move this country in the direction that he would like it to go, provided he recognizes what Rose and I believe is the greatest mistake he made during his first term. When Ronald Reagan took advantage of his honeymoon, he made what seemed like bold proposals for cuts in taxes and cuts in government spending. But they weren’t bold enough. If he had asked for much more, he wouldn’t have gotten everything he asked for, but he would have gotten more than he did. And he would have generated no greater opposition. In my opinion, the key to success for a new administration is to take advantage of that honeymoon and make extremely bold proposals. If Reagan makes sufficiently bold proposals, if he prepares in advance a detailed program to be implemented once elected, and if he resists the temptation to make promises during the campaign that are inconsistent with his basic philosophy, he may have another chance to make a real impact.

But why is it so difficult to change things? Why is it that after an initial honeymoon everything seems to come to a halt? What is this tyranny of the status quo? The fundamental answer, I believe, comes from recognizing that, in our political system or in almost any political system, the most powerful group is not the majority but a small group in favor of a governmental program that will confer large benefits upon it at small costs to everybody else, costs that can be spread widely over the population at large. That is the group that has the greatest political power.

Let me give a very simple example. When this country was founded in 1776, nineteen out of twenty people were on farms. It took nineteen out of twenty people to grow enough food to feed
themselves and the one other person. Twenty to twenty-five years ago, the number of workers and entrepreneurs on farms had shrunk to about six million out of a population close to 200 million, or less than 5 percent. In the early days of this country there were no farm support programs. But by the 1960s there were, and those farm price support programs were doling out money that amounted to something like $200 per person employed on farms. Today, twenty-three years later, there are half as many people employed on farms and the farm programs are doling out $6,000 per farm person employed. The farmers have more political clout when they are few than when they are many, and the reason is very simple. If they are few, it matters a great deal to each one of them. It pays each one of them to spend a lot of effort on trying to get a government program on his behalf. If they succeed, it will cost us something like $50 to $100 a year per person. It doesn’t pay one of us to go down to Washington and lobby against the program in order to save $50 or $100. It doesn’t pay us to keep informed about what happens. That is why we are ruled by a special kind of majority, a majority that is composed of a collection of minorities—3 percent who are in favor of this, 2 percent who are in favor of that. If you want to get elected to Congress, don’t try to find out what the majority wants, try to build a coalition of 2 percent plus 3 percent plus 5 percent. The tyranny of the status quo is embodied in what has come to be called in Washington the “Iron Triangle.”

The “Iron Triangle,” like every triangle, has three corners. In one corner are the beneficiaries of the tyranny of the status quo: the farmers, the maritime industry, the automobile industry that’s seeking to cut down on imports from Japan, the steel industry that’s trying to prevent the American people from benefiting from cheap imported steel, and so forth. Another corner of the Iron Triangle consists of the politicians: the president, members of Congress, the state legislators, the governors. Politicians get their funds to run for election from the beneficiaries of the government programs. And the third corner, and by no means the least important, is the bureaucrats. An Iron Triangle exists in every area: in the military, among defense contractors and Congressmen who head the armed services committees, among bureaucrats, and in the Pentagon.

The issue is well illustrated by education. You would think that the beneficiary corner of education and schooling would be parents and children. They are the ones who have most at stake. But their
position in the beneficiary corner has been preempted by teachers, school administrators, and teachers’
unions. Why? Because teachers, school administrators, and teachers’ unions are relatively few and
concentrated. When government money is spent on education, each group gets what to each of them is
a relatively big chunk. The parents and the students are many and dispersed. They have the most to
gain or lose, but they have little to say about what goes on. Unless parents are fortunate enough to be
able to send their children to private schools, they have very little to say about what goes on in the
classroom. That’s being determined by the professional educators. One report after another documents
how terrible our educational system is, how low the quality of our schooling is, how SAT scores are
going down. Why is this happening?

It’s happening because our school system is centralized and bureaucratic, because it’s a
governmental, socialist school system. And yet what has been the reaction? The teachers’ unions are
saying, “You know very well the trouble. The trouble is there isn’t enough money.” The truth is that
the amount of government money being spent per child, even after allowing for inflation, has been
going up sharply. In fact, it’s been going up almost as sharply as the performance of students has been
going down. But nonetheless, they are one corner—and a highly effective and influential corner—of
the educational Iron Triangle. Another corner, of course, is the politicians—the legislators in the state
houses, the Congressmen, and the educational committees. And the third corner is the bureaucrats who
administer these programs.

One of candidate Reagan’s goals when he assumed office was to eliminate the newly created
Department of Education. The federal government has no business playing a major role in elementary
and secondary education. That should be a responsibility of the local communities. But increasingly,
the federal government has been expanding its role. The Department of Education was established
because the National Education Association contributed large sums to the campaign for the nomination
and election of Jimmy Carter. That’s putting it bluntly, but accurately and exactly. And President
Reagan, quite properly, wanted to abolish it. That hasn’t happened and there’s no sign that it will
happen. The Secretary of Education is a fine man who says all the right things, but words aren’t going
to solve problems.
The right solution is to eliminate centralized bureaucratic control of the public school system, of elementary and secondary schools. The best way to do that is through a voucher system under which parents will have the opportunity to choose the schools their children attend. That would substitute the principles of a private enterprise economy for the principles of a socialist economy. There is no more difficulty in understanding why our school system cannot teach our children than there is in understanding why the Russian agricultural system cannot feed its people. Both are socialist institutions, and in both cases, socialist institutions operate in the interests of the producers and not in the interests of the consumers.

The most recent Gallup poll on this subject showed that, for the first time, a majority of the people polled favor an educational voucher system: 51 percent were in favor, 38 percent opposed, 11 percent undecided. Two years ago only 43 percent favored it. In the state of California—two dedicated people in Sacramento, Roger Magyar and Leroy Chatfield—are trying to promote an initiative to introduce a voucher system for the state of California. The first attempt to get such a system approved by initiative was made years ago in Michigan, and failed. It failed, of course, because the teachers’ unions, the educational bureaucracy, and the public schools, joined forces to oppose it. They will do the same in this state, and they will succeed unless the people are informed by the Pacific Institute for Public Policy Research and other organizations whose function is to educate.

What lessons can we draw from what has happened? What lessons can we draw about surmounting the tyranny of the status quo? I believe that the majority of the American people are in favor of cutting down the size of government. They are in favor of getting more control over their lives. The problem is how to make that effective. One obvious lesson is that we cannot succeed simply by electing the right people to Congress, because once the right people are elected to Congress they will proceed to do the wrong things. And they will proceed to do the wrong things because the people who elected them will demand that they do the wrong things. Let’s not blame the politicians; we’re the ones who are to blame. We are all of us special interests. We are all in favor of cutting down government, provided it’s a government program that benefits somebody else. So that even though we all elect people to Congress because we would like to see the size of government reduced, once they
are elected it is in our self-interest, understandably, to protect the special privileges that we separately enjoy. And that behavior is entirely rational. Our interest, too, is concentrated. We can hope to accomplish something by working with the small group that has the same concentrated interest. We feel—and to a considerable extent are—largely impotent in having any individual influence on broad diffused problems.

The key problem is how to arrange a package deal. The problem is most individuals would be willing to give up the special privileges they enjoy if they were confident that all the other special interests would give up theirs. But there is no way to arrange a package deal through the Congress. Congress considers each proposition separately. When each proposition is considered—for example, cutting funds for what I think to be one of the most disgraceful of all programs, namely, subsidies for higher education—what happens? You don’t hear from the citizens who pay the taxes. You hear from the people who teach at those schools, you hear from the students at those schools, you hear from the concentrated special interests, and the taxpayers have no representatives.

How can we arrange a package deal? Fundamentally, there are only two ways. One is the presidential route and the other is a constitutional route. The president and the vice-president are the only people elected in this country to represent the public at large. All other officials are elected to represent a particular constituency. Therefore, a president is in a position to take a broader view, to propose package deals in the interests of the public at large. That is what Ronald Reagan did in his first year in office. It is what I hope he will do again if he is reelected in 1984.

But that solution is not, in my opinion, an effective route for the long run. A president, at most, serves for four or eight years. The bureaucracy was there before he came and will be there after he leaves. They have their fingers on all the levers of power. They are a key corner of the Iron Triangle, and are not likely to be defeated permanently by the presidential route.

The most effective way to arrange a package deal is through the Constitution. That’s what the Constitution is for. The Constitution, itself, was originally drawn up as a package deal. There is hardly a provision in it that could have gotten approval from all thirteen original states if each provision had been considered separately. It was because it was a package deal in which the big states got more
representation in the House of Representatives and the small states got equal representation in the Senate and so on down the line, that it was approved.

Similarly today, a constitutional amendment is a way in which we can arrange a package deal. That method is being used. For example, the National Tax Limitation Committee headed by Lewis Uhler and the National Taxpayers Union headed by James Davidson have been extraordinarily effective in promoting a constitutional amendment to balance the budget and limit the growth of taxes—the Balanced Budget and Tax Limitation Amendment. It passed the Senate by the necessary two-thirds majority last year. It passed the House by a majority, but not two-thirds. Thirty-two states now, the latest one being Missouri earlier this year, have asked Congress to call a constitutional convention to propose an amendment to balance the budget and limit spending. It would be marvelous if we could hold one. I think the first one did pretty well, and I would like to see another one. In fact, I’d love to be a delegate to such a convention. But unfortunately, it will not be held because Congress is too jealous of its powers. As a result, if a thirty-third state ratifies the amendment (thirty-four is the number required), the amendment will be passed by Congress faster than you can say “Lewis Uhler.”

If the Senate and the House both pass it by a two-thirds majority, the necessary three-quarters of the states will pass it within a very short period of time. I believe that is by all odds the most effective way of trying to effect a change that will have lasting power, that will not be a momentary flash in the pan, and that will really start us on the road to cutting down the size of government.

It’s not the only such amendment we need. There has been much talk about the desirability of giving the president an item veto. An item veto would make the presidential route more effective. We need a constitutional amendment to substitute a flat-rate income tax for our present monstrous income tax. Again, it will be impossible to get a true flat tax adopted by Congress, in my opinion, because if there were no loopholes in the tax laws—if there were no special privileges to be gotten through taxes, no special benefits—where would Congress raise its election funds? We also need a constitutional amendment to discipline our monetary system, enabling us to have some confidence in what a dollar will buy five, ten, fifteen, twenty years from now.
That’s a pretty big agenda, but this is a pretty big country. The American people do, ultimately, control their government. They can overcome the tyranny of the status quo. Fortunately, for this country, it’s the only real tyranny we have to fear at the moment. There is nothing wrong with the United States that a dose of smaller and less intrusive government would not cure.

Questions and Answers

How can the lesser developed countries’ (LDCs’) “debt bomb” be defused without turning on the printing presses and driving us into an even worse cycle of inflation?

The LDCs’ debts can be defused by some banks losing a lot of money. The banks made the loans at good interest rates, and got high returns from them. I think in our system of profit and loss, we cannot possibly say that the government should bail the banks out of the bad loans they make, but allow them to keep the profits on the good ones.

Personally, I am strongly opposed to the increased quota that is being proposed for the International Monetary Fund (IMF). I believe the IMF is an organization that has no real function and ought not to exist. And that, in fact, we will do the LDCs far more harm by continuing the policies of making loans to their governments. The fundamental problem of the LDCs is that they have been centrally governmentally directed, controlled, and regulated societies. Those LDCs that have had the sense to use a market system, like Hong Kong, Singapore, and Taiwan, do not have to be bailed out; not one of them is in trouble. Which are the ones in trouble? It’s the ones like Mexico, where 70 percent or more of the productive apparatus of the country is owned by the government; like Brazil and Argentina, where military governments have been controlling the economy. Those are the ones that have to be bailed out, and bailing them out only encourages them to continue policies detrimental to their citizens.

So I think the way you solve the LDC “debt bomb” problem is to require the people who make the loans to collect them. If they can, fine, and if they can’t, that’s their problem.

Should the Federal Reserve system be decentralized and, if so, how?
No, the Federal Reserve system should not be decentralized, it should be abolished. The Federal Reserve system is now decentralized: there are twelve Federal Reserve banks around the country and the presidents of those twelve Federal Reserve banks attend the meetings of the Open Market Investment Committee. The solution is to replace the Federal Reserve by a computer directed by a constitutional amendment.

_Secretary Donald Regan says there is no connection between the federal deficit and interest rates._ Would you care to comment?

The connection between the federal deficit and interest rates is small. The problem of this country is not the federal deficit but the amount of government spending. Some of the people who have done the most harm unwittingly are the fiscal conservatives who have consented to higher taxes supposedly in order to balance the budget. The only effect has been to increase government spending.

If government spending today was the same percentage of the national income as it was four years ago in 1979, we would have no deficit today. The deficit has not been created by tax cuts. The deficits have not been created because taxes are too low. The deficits have been created because government spending is too high. And the people who are crying most about the deficits today are born-again budget balancers. They are the people who have brought us our present situation, and they don’t want to eliminate the deficit. What they want to do is to get higher taxes so they’ll have more to spend. And the fiscal conservatives, in my opinion, will do their own cause an enormous amount of harm if they continue to stress the deficit, instead of what the real problem is—which is the level of government spending.

_Will the prime rate go up or down in 1984?_

_What is your projection for the Dow for the end of the year?_

I never predict the stock market; I follow the good example of John Pierpoint Morgan, who, when asked what the stock market would do, said, “It will fluctuate.”

With respect to the prime interest rate, the answer is obviously yes. But underlying these two questions is a third: What are the prospects for the American economy in 1984? That’s a question we can say something about more clearly.
Two scenarios seem possible. At the moment, it is not entirely clear which will develop. One scenario is that the economic expansion we are now in will be a short one, like 1980 to ‘81, and will end sometime in 1984. I think that’s not unlikely. We had a monetary explosion from the middle of 1982 to the middle of 1983 with a rate of monetary growth that is higher than in any twelve-month period since World War II. That rate of monetary growth is the reason we have been having a more vigorous expansion than anybody except the monetarists predicted.

Since about July, monetary growth has tapered off and slowed down sharply. If the Fed reacts as it has reacted in the past and swings from one extreme to the other, we will have a recession sometime in 1984. That’s the major source of my concern about the probability that President Reagan will be reelected. If that recession comes in the first or second quarter, there will be at the time of the election rising unemployment, rising inflation, and rising interest rates—not a scenario in which a president can be easily reelected. Should that happen, then I think the chances are very good that we will be back in a very inflationary atmosphere by 1985 or 1986, and that much of the good that has been done will be undone.

The other scenario is that we will be lucky and the Fed will not behave as it has in the past. Should it find that mystical middle ground it’s always seeking and never finding, the expansion will continue throughout 1984 or at least until the third or fourth quarter of 1984, in which case the odds are pretty good that President Reagan would be reelected and that he would support lower government spending and a more restrictive monetary policy thereafter. In that case, the higher inflation in 1984, which will inevitably come, would be another blip, but we’d be headed downward.

It is very difficult to say which of those scenarios will prevail. To do so, one must be able to predict what the Federal Reserve Board will do, what the system will do, and what will come out of that machinery. I have always been much more successful in predicting the consequences of what the Fed does than in predicting what it will do.

Do you fault Mr. Reagan at all for not pushing hard enough, and is there anything specific right now that you would like to see him do or push harder for?
I believe that a president has a great deal of influence but not a great deal of power. So I don’t really believe that the major fault is President Reagan’s. But there are some things for which I would fault him.

The area in which I would be most critical is foreign trade. When he was here in San Francisco not long ago, he gave a talk at the Commonwealth Club, and in that talk the general statement he made about the desirability of free trade was absolutely first-rate. On the other hand, he and his administration have acceded to or promoted specific measures that are contradictory to those general principles: the so-called voluntary quotas imposed on imported Japanese cars, the enormous jump in the tariff on heavy motorcycles in order to benefit one company—Harley-Davidson—the recent measures on specialty steels from Europe, the subsidization of grain exports to Egypt. These are all absolutely contradictory to the general principle of free trade. The Administration might defend itself by claiming those actions were necessary to prevent Congress from taking even less desirable measures, but nonetheless, I wish that the administration had stood more forthrightly against those and in favor of free trade.

In general, though, I don’t believe the fault is with the President. The fault is with the system, which allows, once the initial honeymoon is over, the tyranny of the status quo and the Iron Triangle to prevail.

*How much of your criticism of monetary policy do you feel is the result of the fluctuations in the position of the administration and the pressure it has put on the president?*

None because the Federal Reserve has behaved that way for seventy years. Moreover, to explain the immediate situation, the crucial date is October 1979; that was almost a year and a half before this administration came into power, and if you look at the pattern, it was roughly the same from October 1979 until July 1982. The pressures put on in the last half cannot possibly account for what happened in the first half.

There is a great misunderstanding about monetary policy and an enormous tendency to personalize it. So we talk about the Volcker policy, or the Reagan policy, or the Carter policy.

In almost all large organizations, the person in charge is not necessarily an appropriate indication of what’s going to happen within the organization. Paul Volcker undoubtedly has a good deal of
influence with the Fed, but he is only one of seven governors and one of twelve people on the Open Market Investment Committee. In addition to them, there’s a large bureaucracy with a life of its own. I doubt whether there is a button Mr. Volcker could push that would make any difference.

_Did not the administration, though, reappoint Mr. Volcker and did they make a mistake in reappointing him?_

In reappointing Mr. Volcker? Yes, I said it at the time, I’ve said it before, and I’ve said it since: I think his reappointment suggests that the administration approves of the policy that was followed under Paul Volcker’s regime.

Paul Volcker may not be to blame, but he has to be regarded as responsible for the policy that was followed. His reappointment is a clear indication that the Reagan administration approved what I believe to have been a very unfortunate monetary policy. It brought inflation down; that was a good thing. But it brought inflation down by a highly erratic monetary policy that made the accompanying recession much more severe than it otherwise would have been—by a policy that made interest rates higher than they otherwise would have been. On the whole, therefore, that was not a good monetary policy; it was a very bad one.

When Reagan outlined his economic program during the presidential campaign in September 1980, his four planks were (1) reduce government spending, (2) reduce taxes, (3) reduce regulation, and (4) maintain a stable, moderate monetary policy. But monetary policy has been anything but stable. There is no three-year period in monetary history, to the best of my knowledge, in which the growth in the quantity of money has been as unstable as in the period from October 1979 to October 1982. Reality did not accord with the plank in Mr. Reagan’s platform. I do not believe a vote of approval should be given to a monetary administration that has departed so far from the President’s fundamental desired policy.

_How and when do you suggest that we go about abolishing the Federal Reserve?_

That depends on how radical a reform you want to make. The simplest and perfectly feasible thing to do would be to divide the operations of the Federal Reserve into its two very different functions: (1) regulating and supervising the banking system, and (2) controlling the quantity of money. Assign the former function to the two other federal agencies that have the same function, namely the Federal
Deposit Insurance Corporation and the Controller of the Currency, and have one regulatory authority. (I’m not approving of that, I’m merely responding to the question.) And then take the function of controlling the money supply and transfer that to the Treasury Department. Such a solution would be a great improvement over what you have now.

A more fundamental reform would be a constitutional amendment limiting the total quantity of non-interest-bearing money created by the federal government—whether in the form of currency or deposits—either fixing it once and for all or allowing it to grow at a specified rate. Then simply dismantle the Federal Reserve.

There are two separate issues involved here: the issue of controlling the quantity of money and the issue of what kind of regulation, if any, should control the banking system. The two raise very different problems. At the moment, I was only talking about the first of those functions.

*You mentioned that if we get lucky, the economic expansion may continue into 1984; what is the most likely course of events?*

The first scenario is that a recession begins in the first or second quarter of 1984, producing an economic environment in which a new president is elected. Under those circumstances, the new president would move to the traditional democratic practice of tax and tax, spend and spend, elect and elect. And that would almost surely set in motion developments that would lead to renewed inflationary prospects for 1984 and 1985. In fact, given public opposition to inflation, there would be great pressure even under those circumstances to stop it, which, in turn, might lead to renewed price and wage control.

The public’s memory is relatively short. By that time, it will be over a decade since Richard Nixon made his major mistake of imposing price and wage control, and since we felt the serious consequences of that. It will be a shorter period of time since we had double-digit inflation. A new administration and Congress might very well, under those circumstances, resort to price and wage control in an attempt to suppress the inflationary pressure instead of letting it express itself openly. The result would be even worse inflation a few years later, as happened after the 1971 price controls broke down and had to be abolished. That is one possible and very unfortunate scenario.
The other scenario is that the expansion will continue through most of 1984. A new election under circumstances more favorable to the incumbent, will likely lead to a reelection of the president, who will move, as he has before, to hold down spending. With a constitutional amendment to balance the budget and limit taxes, we can gradually ratchet inflation back down.

Let me emphasize, under either case, there will be higher inflation in 1984 than in 1983. It’s unavoidable because, somehow or other, this extra money that’s been pumped out has to be absorbed. It’s got to come out. So there will be higher inflation in 1984, but that doesn’t mean it’s going to be double-digit inflation. The inflation currently is running 3 to 5 percent. In the middle of 1984, I believe it will be in the neighborhood of 6 to 9 percent. That is the direction we’re heading.

There was a monetary explosion from July 1982 to July 1983. The quantity of money, M–1, went up by 14 percent. A monetary expansion of 14 percent cannot be absorbed without it sooner or later coming out in the price level.

A lot of people think that the velocity of money is. . .

I wrote a piece in the Wall Street Journal a few weeks ago dealing exactly with that issue, and I refer you to it.

The problem with the velocity is that it went down for reasons that are perfectly understandable. At the moment, it’s much more likely to go up than down, and if it goes up, it will just exacerbate the effect.

Doesn’t the Fed have a problem now defining money?

Throughout the history of the Federal Reserve, every single time it has been subject to criticism because it doesn’t quite know what to do, its favorite excuse is that there is a problem of defining money. That excuse is utterly irrelevant and just is not the case. The monetary explosion started before the new forms of bank deposits were introduced, the so-called money market accounts. The “super-NOWs” were first introduced in October 1982, again in January. But the monetary explosion started in July. The monetary explosion that started in July can’t be explained by the authorization of new forms of deposit. The problem of defining money is just a smokescreen to ward off criticism.

Do you think the market is being tricked by this? Why is the market continuing to go up, if inflation is on the rise?
Because we are in a very vigorous economic expansion, there’s no doubt about that. Historically, the initial stages of renewed inflation are very good for stock markets. When the stock market really zoomed back in the 1960s and ‘70s, it was when we were just starting to get into this inflationary spiral. In the early stages, prices and profits go up before wages and costs go up. That’s very good for the stock market. Only as that process gets underway and people start to learn what’s happening and adjust to it, and wages and other costs start going up, is there an adverse effect on the market. We are currently in the first stage. We’ve come through a sharp disinflation and seem to be in the early stages of a re-inflation. However, I do not predict that the Dow will plunge, for I don’t predict anything about the stock market.

_Early on in the Reagan administration, we heard talk from the supply-siders about the only way to really get a handle on this inflation is perhaps to go back to the gold standard. Is that any kind of solution?_

No, but there are supply-siders and there are supply-siders. I’m a supply-sider and I never talked that way. Lots of other supply-siders did not talk that way, either. Jack Kemp, Art Laffer, Jude Winniski—this small group of people did talk that way. They had overpromised on what the tax cuts would do. To have an excuse, they turned to a gold standard, an understandable human reaction. But it’s not fair to label all supply-siders with that view.

The United States was under a gold standard from 1879 until the first World War, and in a modified form until 1933. That did not prevent sharp ups and downs in prices. Under the gold standard, there was a period, from 1879 to 1897, when prices were falling about 3 percent a year. From 1897 to 1914, prices went up about 50 percent. So the gold standard does not prevent sharp short-term movements. The price level was stable on an average over a long period but even in its heyday, the gold standard was not the ideal standard.

Furthermore, government establishes a gold standard, and can abolish it as well. It has done so in the past, and it would do so again. Few people who say they’re for a gold standard—and Ron Paul is one of the few—are in favor of an honest-to-God gold standard in which gold is really used as money. Most advocate a managed gold standard. I see no reason why a government would manage a gold standard any better than it manages a paper standard. Finally, a gold standard makes real sense only if
it is international. And there is no other country in the world prepared to go that way. So the suggestion is a nonstarter.

There is nothing to prevent the United States from having a gold standard in a different sense. Conrad Braun has a gold standard corporation in Kansas City. He’ll hold deposits in the form of gold; checks can be written on those deposits and transferred to somebody else. There is nothing at the moment to prevent people in this country who want to from using gold as their medium of exchange. Not very many people are going to do so. For those people who are really in favor of a gold standard, that’s the route they ought to take. They ought not to ask government to reestablish it. As Conrad is always saying, “The real issue is a free market and not free gold.” Private people who want to operate on gold, there’s nothing to stop them. And I’m all in favor of eliminating any obstacles whatsoever to private individuals transacting in whatever medium they want to. There is nothing to stop people from using Swiss francs if they want to make a deal with somebody else. And there shouldn’t be. The Gold Standard Commission, established by the government, discovered that nobody was in favor of the gold standard except Ron Paul. The rest was all talk.

*Are you in favor of abolishing legal tender laws?*

It doesn’t make a bit of difference whether they are abolished or not, for I don’t think they’re really of any importance.

*Could you elaborate on your ideas for an improved educational system?*

A voucher program is simply an arrangement in which the government, now prepared to spend roughly $3,000 a year on your child if you send him to a public school, will give you a voucher worth, let’s say, $1500. You and the government split the money, and you can use that voucher to pay tuition at any school of your choice. The amendment that is going to be proposed in California would provide that such vouchers be usable in both public and private schools and that public schools might receive additional funds from the legislature and the local communities, but they would also receive such vouchers. The sums of money that correspond to the vouchers would be deducted from the funds public schools now receive.
The essential feature of a voucher is that parents are free to choose whether they send their children to a public school or to a private school. Currently, if you want to send your child to a private school, you pay twice for his schooling—once in the form of taxes and once in the form of tuition.

Notes
