The Recovery: Supply-Side or Keynesian?

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The recovery: supply-side or Keynesian?

Although it is clear that the economy has recovered from the worst recession of the postwar period, economists don't agree on why the recovery occurred. The Reagan administration, while disclaiming responsibility for the recession, argues that "supply-side" policies are responsible for a robust recovery. John Kenneth Galbraith describes this viewpoint as the "asymmetrical cyclical syndrome," namely, that recessions are due to uncontrollable events and recoveries to wise policy. The administration's argument, however, is at odds with the facts. The recession resulted from a combination of stringent monetary and fiscal action, but the recovery and boom resulted from Keynesian, rather than supply-side, forces.

The recessions of 1970, 1974–75, and 1980 came about when monetary and fiscal brakes were applied to slow inflation. The 1981–82 recession repeated this pattern. Although fiscal policy in 1981 was moderately restrictive, the Federal Reserve, in its battle against inflation, slashed the annual average rate of growth in the money supply from 10.3 percent in January to −0.2 percent in October (*Economic Report*, 1983, p. 233). The result was a recession devastating to both business and laborers.

Business conditions at the depth of the recession were grim. Gross national product had its largest drop in the postwar period as the unemployment rate rose to its highest level since the Great Depression. The rate of capacity utilization reached a postwar low (*Economic Report*, 1984, pp. 277, 259, 271). These were the circumstances which

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forced a shift in the administration's economic policy. In spite of the supply-side rhetoric, the substantive economic policies of "Reaganomics" became Keynesian by default. This outcome is not necessarily surprising. "Substantive Reaganomics," by cutting taxes and sharply increasing government spending, took advantage of a simple but empirically valid principle, namely, that government deficits stimulate economic activity. This paper documents how Keynesian factors, "supply-side" rhetoric to the contrary, led to the current recovery and boom. Specifically, the enormous deficits, fueled by "supply-side" tax cuts and generous boosts in military spending, led first to increased consumption and *then* to an investment surge.

The theory of supply-side economics

Supply-side economics is new wine in an old bottle. It is a revived version of classical macroeconomics. Classical economists perceive the economy as a complex of markets in which resources are allocated on the basis of relative prices. People decide how much to work, save, and invest and what to consume based upon a comparison of relative prices and costs. Full employment is always achieved in such a world because labor is treated simply as a resource. For the classical economist, the only reason why a resource is not employed is that its price is greater than the value of its marginal product. If this is not enough, the classicals look to "Say's Law," which asserts that the act of producing a good automatically creates demand equal to the value of the good produced. Therefore, gluts cannot happen, let alone cause unemployment. If there is unemployed labor, it is only because the real wage is too high.

Supply-side economists argue that these essentially classical ideas are applicable today. George Gilder, a leading supply-side devotee, writes that "the essential thesis of Say's Law remains true: supply creates its own demand. There can be no such thing as a general glut of goods" (1981, p. 39). Indeed, if we have unemployed people, and unused factory capacity, capitalism shouldn't be blamed, nor Say's Law abandoned. Instead, the blame lies with the government. Government taxes and regulations stand between conditions of unemployment and stagnation, or full employment prosperity. Arthur Laffer has called this the "Wedge" effect. Taxes and regulations of all kinds mean that people do not receive the full benefit of their productive effort. Some of that effort is taken to fulfill government requirements. Government,

then, becomes like a wedge between the incomes that people actually receive and the income which people earn in the marketplace.

Government affects the level of aggregate output by altering the relative prices of such things as work, leisure, and saving through its taxing and regulatory policies. These relative price changes are supposed to affect incentives to work, save, and invest. If, for example, the market rate of interest is 15 percent, but the government taxes away 5 percent, then people may save less because of the lower return on savings. The government affects the incentive to save by taxation, thus making the benefits of saving smaller relative to other alternatives. That the government comes between people and the market is an essential thesis of supply-side economics, described by Laffer as the "new economics of individual incentives" (1979, p. 116). This view is the basis of Paul Craig Roberts's summary of the supply-side position, that "the essence of supply-side economics is to regard tax-rate changes as relative price changes affecting the supply and form of labor, savings, investment and visible economic activity" (1980).

According to supply-side doctrine, the government can increase output three ways: by cutting social welfare programs, by deregulating the economy, and by redistributing the tax burden away from the wealthy and business. The objective is to reduce the effect of the government wedge on prices and on incentives. Let us now contrast the theory of supply-side economics with evidence from the real world.

The reality of supply-side economics

Social spending, taxes, and work incentives

The Reagan administration relied on supply-side theory for its *Program for Economic Recovery*, which cut social programs, deregulated business, and cut tax rates. The primary purpose was to reduce the government wedge. The world, however, is different from what the administration believed.

When tax rates are cut the government must either reduce spending or increase its deficit. The Reagan administration has done both, generating record deficits along with major cuts in social programs. Although the administration claims that it has only cut the rate of growth in low income assistance programs, this is only partly true. Table 1 compares spending in constant dollars on these programs in 1980 and

Table 1

Cuts in low income assistance programs: 1980–1983
(in billions of 1972 dollars)

Programs	1980	1983	Percent change
AFDC	4.1	3.6	−12.2
Medicaid	8.0	8.9	11.1
Supplemental Security Income	3.3	3.4	3.0
Food stamps	4.6	5.2	13.0
Veterans (non-service connected)	3.9	3.7	−5.1
Earned income credit	0.7	0.6	−14.3
Other	12.2	10.0	−18.0
TOTAL	36.8	35.3	−4.1

Source: Survey of Current Business, Washington, D.C.: U.S. Government Printing Office, July 1983, 1984.

1983, showing also the percentage change in these programs over this period.

The administration cut these social welfare programs by 4.1 percent in real terms. These cuts may appear small, but they came at a time when the need for the programs was increasing. Between 1980 and 1983 the number of people who fell below the poverty line and were not covered by Social Security old-age benefits increased by 15.9 percent. As a result of the decrease in benefits and the increase in need, the amount of income assistance provided for each individual client fell by 27.8 percent. A similar pattern existed for those who were unemployed. The ratio of federal unemployment benefits to the number of people unemployed fell by 10.5 percent.[1] Under this administration, the "social safety net" has become more loosely woven.

There was, of course, no malevolent intent. The poor and unemployed, it is claimed, will not work if they can get income from the government (Feldstein, 1973, pp. 3–42). Supply siders argue that social programs such as unemployment benefits and welfare spending

[1]Data for the number of people falling below the poverty line is from "Consumer Income, Money Income and Poverty Status of Families and Persons in the U.S., 1980 and 1983," *Current Population Report No. 145*, p. 60. Data for the number of people unemployed is from the *Monthly Labor Review*, September 1984, p. 55.

reduce individual incentives to work by giving benefits which are higher than the income that these people could get from the market. As Gilder wrote,

> Any welfare system will eventually extend and perpetuate poverty if its benefits exceed prevailing wages and productivity levels in poor communities . . . As long as welfare is preferable (as a combination of money, leisure, and services) to what can be earned by a male provider, the system will tend to deter work and undermine families. (1981, p. 122)

The basic difficulty with this sentiment is that people *cannot* respond to work incentives in the way supply siders believe. Labor markets simply don't work that way. If employers are not hiring more workers or offering more hours, reduced social spending will not lead to increases in the amount of labor actually employed, but will simply cut off income to the poor and unemployed. Indeed, if workers were able to work more in response to material incentives we would expect that changes in average earnings would be positively related to changes in the labor supply. The data do not support this conclusion. Figure 1 shows that, over the past 30 years, changes in the labor force participation rate, used here as a proxy for labor supply, have not been correlated with changes in earnings.

Work incentives are also supposed to be increased by cuts in marginal tax rates. Since taxes are a part of the government wedge, presumably they create a disincentive to work. The supply siders claim that, if the government takes less in taxes from each additional dollar of earnings, people will be encouraged to work more. Once again, however, evidence stands in the way. The Department of the Treasury's Office of Tax Analysis has calculated marginal tax rates for five-year intervals since 1965 and yearly for 1981–84. These data, which are found in the 1982 *Economic Report of the President* (p. 120), show that between 1965 and 1980 the marginal tax rate for median income families rose from 17 to 24 percent. For high income families, the increase was from 22 to 43 percent. Yet in the same period, the labor force participation rate (for civilian workers) also rose, from 58.9 percent to 63.8 percent, a change upward of 4.9 percentage points. After 1981 and as a result of the Economic Recovery Tax Act of 1981, the marginal tax rate for a median income family fell from 27.7 percent to 25 percent, and for upper income families from 42.5 percent to 38 percent. However, the labor force participation rate remained nearly constant, increasing by

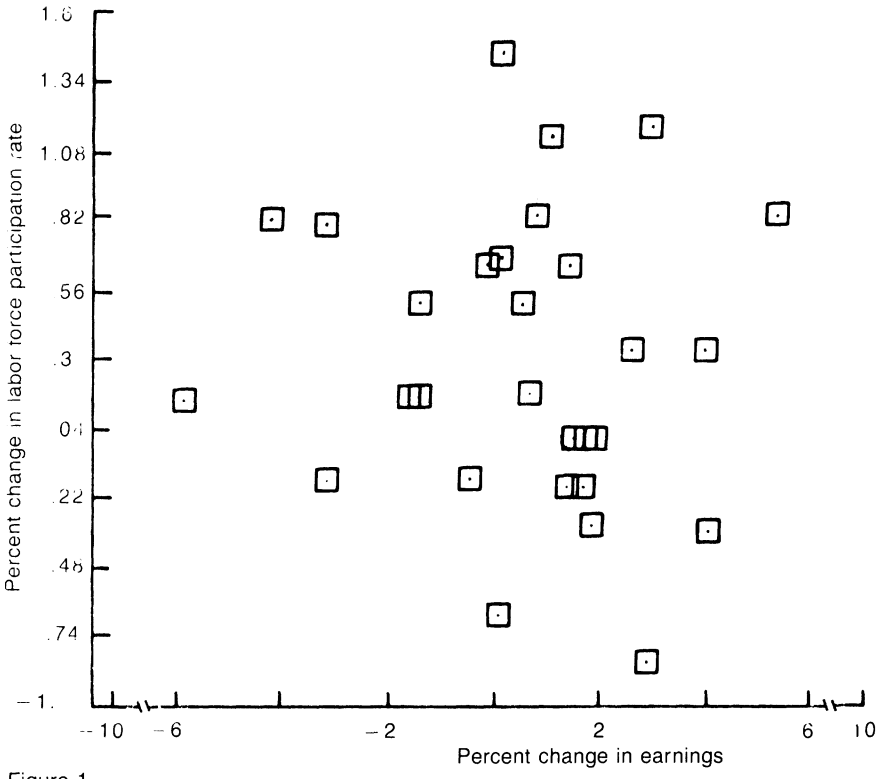

Figure 1

Source: The Economic Report of the President, Washington D.C.: U.S. Government Printing Office, 1984, pp. 258, 265.

only 0.6 of a percentage point during this time. These are hardly the results predicted by supply-side theory.

Deregulation

A second major source of growth for supply-side advocates is deregulation. Once again the government wedge comes into play for the supply siders. Regulations impose costs on producers which, assuming a competitive economy, tend to reduce output. Murray Wiedenbaum has estimated that government regulations cost the economy $100 billion each year (1977), a figure that has been vigorously disputed (Tabb, 1980, pp. 40–48).

The logic of deregulation is straightforward. By eliminating work safety rules and protection for workers against discrimination in labor

markets, and not enforcing or eliminating laws protecting the environment, private profitability is enhanced. Then the economy is freed from its shackles and allowed to grow. In other words, private profitability and the market are substituted for conscious protection of the health and well-being of society.

We should not forget, however, that the laws which the supply siders and the administration wish to eliminate evolved due to racial and sexual discrimination, work safety problems, and environmental disasters that continue to pose a threat to public safety and public welfare. Further, a U.S. Senate study of the productivity slowdown and international competitiveness concluded that the contribution of government regulation to these problems is small (Committee on Finance, 1980).

The debate over the benefits of deregulation continues with strong claims on all sides of the issue—hence, this is a very difficult area in which to make broad generalizations. Yet, there are important questions whether, in purely economic terms, costs are appreciably reduced and productivity significantly increased by deregulation. In 1983 the administration's "Task Force on Regulatory Relief" reported that important reductions in cost could be achieved by removing many present or proposed regulations. Yet, in their haste to claim much for deregulation, hidden costs were ignored. For example, Perry D. Quick of the Urban Institute has observed that lowering the impact standards for automobile bumpers from 5 to 2.5 miles per hour would indeed lower the cost of automobiles in addition to reducing fuel costs for consumers. He adds, however, that, when one considers the increased insurance and maintenance costs, the direct savings may well be erased. Further, if the indirect costs are greater than the direct savings the effective cost of an automobile to the consumer will rise, leading to less demand and revenue to producers (Quick, 1984, pp. 310–311).

Using data from a study by Gregory Christianson and Robert Haveman on productivity and deregulation, Quick finds that, "if the reduction in the regulatory burden within five years were $7 to $10 billion . . . [and] if these savings were fully realized, annual productivity improvements in the business sector could be as much as 0.2 percent points" (1984, p. 311). This is a very small productivity improvement given such a large reduction in costs. Quick also notes that "the long-run significance of this already optimistic estimate is further reduced because a given set of actions will produce a temporary boost to productivity growth. Additional boosts will come only to the extent that new relief actions are taken" (1984, p. 311).

In *The Great Transformation*, Karl Polanyi explains that, as capitalism's market institutions evolved, there also evolved a corresponding set of institutions for society's protection (1944). A modern capitalist economy exists as a part of modern society. Higher standards of living, more secondary and higher education, better health care, and other characteristics of modern society make people less willing to accept air pollution, toxic wastes, dangerous workplaces, or discrimination. Because of this, social regulation is not only important, but it is inevitable. James Tobin, for example, recently addressed this fact of modern life, stating that

> . . . plant and equipment is not the only social capital. If we wish as a society to make better provision for the future, we should also be concerned with the preservation and improvement of human capital, natural resources, and public sector facilities and infrastructure, all of which are sacrificed . . . by the ideology that only private business is productive. (1981, p. 13)

Supply-side tax cuts without supply-side results

The third thrust in the supply-side argument is that cuts in marginal tax rates and business taxes when coupled with more liberal depreciation allowances will lead to higher productivity, higher savings, a surge in investment, and a lower deficit. Clearly, this was the outcome foreseen in the Reagan administration's 1981 *Program for Economic Recovery*. "In contrast to the inflationary demand-led booms of the 1970s," this document says, "the most significant growth in economic activity will occur in the supply side of the economy" (*Program for Economic Recovery*, 1981, p. 25).

Roberts is one of the leading proponents of the view that the recovery has been investment-led, a development brought about by the supply-side policies of the Reagan administration. Recently in *Business Week* Roberts said:

> The picture of the recovery presented by statistics on the gross national product is unambiguously clear. It is that of an investment led recovery . . . The GNP statistics are loaded with facts that vindicate the supply siders and embarrass their critics. (1984, p. 16)

The trouble with the foregoing is simply that the recovery and boom don't fit the supply-side scenario. To repeat, if supply-side magic had

worked, we would have had increased productivity, an increase in the ratio of personal saving to personal income, an immediate surge in investment spending, and a smaller federal deficit. None of these happened.

As a matter of fact, productivity grew at a pace slower than during any other postwar recovery. The average annual rate of productivity growth during the other postwar recoveries was 3.5 percent. Yet, in 1983 productivity increased by only 2.7 percent. This rate is only slightly higher than the average rate of productivity growth for the whole postwar period of 2.5 percent (*Economic Report*, 1984, p. 266).

The savings rate also fell during both 1982 and 1983, to 6.2 percent of disposable income in 1982, and 5.0 percent in 1983. It should have gone the other way. Too much should not be made of this decline in the savings ratio, even though the supply siders believe that increases in personal saving are translated into new investment. As a matter of fact, savings out of personal income have represented only about 20 to 25 percent of total savings (*Economic Report*, 1984, p. 250). Most of the saving which occurs in the economy comes from business decisions to retain profits and most of the investment which occurs in the economy is financed through retained earnings (Eichner, 1976).[2]

Savings and investment are related, though the line of causation is the reverse of the supply-side belief. Firms will save more because they wish to invest more in the future. Their desire to invest comes from their belief that demand exists for their product. More saving does not create more investment; rather, the desire to invest creates saving.

The Keynesian roots of the recovery

When we turn to the analysis of the supply-side views on the role of investment and the deficit in the recovery we find that the facts show that the key variables behaved more in accord with Keynesian than supply-side theory. We shall first examine the investment and consumption components of GNP and then look at what happened to the deficit during the recession and recovery.

In spite of the views of Roberts, business investment did not play a particularly important role in the recovery. Actually, non-residential investment was basically unchanged during the first quarter of 1983 and rose by just 1 percent for the entire year (*Economic Report*, 1984,

[2]Up to 90 percent of all investment in our economy is internally financed (Eichner, 1976).

p. 222). This has been the typical pattern in post–World War II recoveries.

Through use of a simple technique, the impact of different types of spending on GNP growth can be shown. Because the GNP is an accounting identity, changes in GNP are explicitly accounted for by changes in each of the GNP spending components. In order, therefore, to derive the contribution of any particular spending unit to GNP changes, we need only to calculate the ratio of absolute changes in a particular component to absolute changes in GNP. Table 2 presents calculations showing the relative contributions to GNP growth by personal consumption, non-residential fixed investment, and residential fixed investment. The number of quarters shown for each indicated postwar recovery reflects the number of quarters needed to attain a full recovery.[3] The 1958 recovery, for example, was spread over three quarters. In 1958 IV—the third and final quarter of this particular recovery—the percentage figure for non-residential fixed investment was 10.24 percent; this means that 10.24 percent of the absolute change in GNP in the period was due to the change in non-residential fixed investment. It is possible to have negative contributions by the GNP components. To illustrate in 1958 II, the change in non-residential fixed investment was −61.36 percent. This means that 61.36 percent of the drag on GNP in the first quarter of 1958 was due to this component.

The typical pattern of the seven postwar recoveries shown in Table 2 is one in which housing and consumption spending lead the recovery, each component making a large, positive contribution. This happened in each recovery, while non-residential fixed investment followed with at least a one-quarter lag. In three of the seven recoveries non-residential fixed investment actually retarded growth in GNP. When compared to other recoveries, 1983 was not unusual.

It is also possible to compare the contribution of the GNP components during the 1983 recovery to the average contributions during all of the other recoveries in the postwar period. This is done in Table 3.

Table 3 presents the results of statistical tests to show whether the 1983 recovery was typical or atypical of postwar recoveries. The hypothesis tested is that the contribution of a particular GNP component is basically similar to the average contribution of this component during other recoveries. If the t statistic is greater than the critical

[3]Recoveries are measured as the period between the trough and the point where GNP exceeds the previous peak. This is the standard established by the National Bureau of Economic Research.

Table 2

Percent contributions to GNP during postwar recoveries by GNP components (by quarters)

1954	QIII	QIV		
Personal consumption expenditures	63.64	59.13		
Non-residential fixed investment	13.64	−3.48		
Residential fixed investment	20.45	16.52		
1958	**QII**	**QIII**	**QIV**	
Personal consumption expenditures	84.09	38.75	27.11	
Non-residential fixed investment	−61.36	−7.5	10.24	
Residential fixed investment	0.0	12.5	19.88	
1961	**QI**	**QII**		
Personal consumption expenditures	8.9	37.1		
Non-residential fixed investment	−19.64	8.87		
Residential fixed investment	71.43	12.9		
1971	**QI**	**QII**		
Personal consumption expenditures	48.88	116.67		
Non-residential fixed investment	1.87	24.07		
Residential fixed investment	12.31	92.59		
1975-76	**QII**	**QIII**	**QIV**	**QI-1976**
Personal consumption expenditures	84.25	36.03	70.54	59.93
Non-residential fixed investment	−19.86	5.15	3.57	8.66
Residential fixed investment	6.16	10.29	25.0	12.64
1980-81	**QIV**	**QI-1981**		
Personal consumption expenditures	77.37	42.24		
Non-residential fixed investment	15.33	16.15		
Residential fixed investment	36.56	−0.62		
1983	**QI**	**QII**		
Personal consumption expenditures	75.53	68.29		
Non-residential fixed investment	−6.38	8.86		
Residential fixed investment	52.13	20.29		

Source: Survey of Current Business, Washington, D.C.: U.S. Government Printing Office, 1983.

Table 3

Percent comparison between postwar average and 1983 contributions to GNP growth during the first two quarters of recovery

Postwar averages	QI	QII
Personal consumption expenditures	63.24	56.88
Non-residential fixed investment	−11.34	7.44
Residential fixed investment	18.21	20.25
1983 contributions	**QI**	**QII**
Personal consumption expenditures	75.53 (−1.20)*	68.29 (−1.03)*
Non-residential fixed investment	−6.38 (−.48)	8.86 (−.34)
Residential fixed investment	52.13 (−4.6)**	20.29 (−.0003)

Source: Survey of Current Business, Washington, D.C.: U.S. Government Printing Office, October, 1983.
*Reject the null hypothesis at the 75 percent level of significance.
**Reject the null hypothesis at the 99 percent level of significance.
$n = 7$.

value we reject the hypothesis that the contribution of a particular component is similar to average contribution in other postwar recoveries. By testing this hypothesis, we found that only personal consumption (1983 I and II, at the 75 percent level of significance) and residential investment (1983 I, at the 99 percent level of significance) were significantly different statistically from their postwar averages. Thus, the statistical tests support the argument that 1983 was an atypical recovery, yet not in the sense that it was investment-led. Rather housing and consumption provided a strong lead, and business investment followed.

In the first quarter of the recovery, non-residential fixed investment actually slowed GNP growth, its contribution being a −6.38 percent. While this was a less severe negative contribution than the average, it is hard to argue that a negative contribution to growth represents an investment-led recovery. Further, if we test statistically whether the first-quarter contribution is significantly different from the historical average, we find that there is no significant difference. Clearly, the

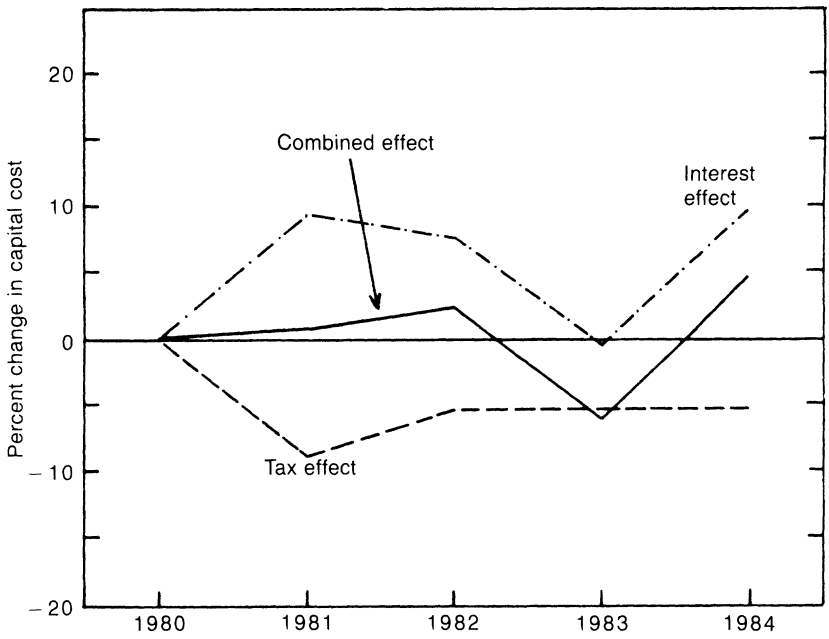

Figure 2

Source: Congressional Budget Office, *The Economic and Budget Outlook: An Update*, Washington D.C.: U.S. Government Printing Office, August 1984, p. 20.

"recovery" in business investment followed the established pattern. Still, supply-side economists may argue that the slow start for investment spending was due to high interest rates which swamped the effect of the tax cuts. Interest rates fell sharply during 1982 (a recession year) and then rose slightly in 1983, the recovery year. To assess the argument that high interest rates retarded fixed investment we can look at how the cost of capital has been affected by both interest rates and tax allowances and investment tax credits. Figure 2 shows the effects of interest rates (the interest effect) and the tax treatment of capital (the tax effect) on changes in the cost of capital since 1980.

When interest rates rise this has the effect of increasing the cost of capital. In Figure 2 this is shown when the "interest effect" line is greater than zero. Tax cuts, because they enhance profits, *ceteris paribus*, have the effect of lowering the cost of capital. The administration reduced taxes on capital in 1982, thereby reducing the "tax effect" on capital costs by 5 percent. We are interested in the combined effect of tax cuts and changes in interest rates.

From Figure 2 it is clear that the combined effect of falling taxes and

falling interest rates throughout 1982 produced decreases in the cost of capital. Further, by late 1982 and early 1983, when the recovery began, the "tax effect" outweighed the "interest rate effect." Business tax cuts lowered the cost of capital and interest rates fell. The net result was to lower the cost of capital by 5 percent in late 1982. When the recovery began the administration's favorable tax treatment of capital was not altered by high interest rates.

Finally, in 1983 the high employment budget deficit reached $94 billion, a record level for the postwar period. This should not have happened if Laffer's curve worked (U.S. Department of Commerce, 1983). How high should the deficit be? Since the administration's program relied on Laffer's curve, a key element in supply-side economics, it is appropriate to use their budget projections to answer this question. In the *Program for Economic Recovery* the administration estimated that in fiscal 1984 the government would actually experience a surplus of $5 billion (1981, p. 9). In fact, in fiscal 1984 the administration confronted an estimated deficit of $195 billion, the largest budget deficit in history.

The behavior of the high employment budget during the recovery period provides evidence which strongly favors a Keynesian interpretation of the rebound from the recession. The high employment budget has evolved as a key technique for evaluating the impact of fiscal policy measures on the economy. We do not have data which directly measure fiscal policy actions in an intended (*ex ante*) sense. However, the Department of Commerce publishes cyclically adjusted data for a high employment deficit or surplus. Once the deficit or surplus is adjusted both for cyclical influences and inflation, any change must reflect discretionary policy actions. Since Keynesian economics believes that changes in the high employment budget will affect spending, it follows that any discretionary fiscal policy changes will lead to a change in the level of economic activity. Using a multiple regression model to test this hypothesis, we obtained the following results.

$$\underset{}{\text{Percent GNP}} = \underset{}{1.23} + \underset{(5.92)}{.226\ (\text{FISCAL3})} + \underset{(8.78)}{1.30(\text{COIND})}$$
$$\underset{(2.92)}{}$$

$$R^2 = .60 \qquad F,2,55 = 41.14 \qquad n = 59$$

FISCAL3 = the cyclically adjusted deficit, or surplus (adjusted for inflation).

COIND = the percent change in the composite index of coincident indicators, used as a control for other cyclical factors.

The validity of this relationship is demonstrated by the fact that the *t* and *F* statistics are all significant at the 99 percent level. Put differently, this means that we reject the hypothesis that there is no relationship between the variables indicated and the change in GNP. It is evident from this statistical model that in the period under review fiscal policy had a direct and significant effect on changes in national output.

To illustrate, quarterly data for the high employment budget deficit show that fiscal policy was expansionary in late 1982 and all during 1983. Using our multiple regression model we estimate that 26 percent of GNP growth in 1983 I and 62 percent in 1983 II—the recovery quarters—was due to fiscal variables. The revived cold war of the Reagan administration contributed heavily to this stimulus. During the recovery period, nondefense federal spending fell 10.6 percent while defense spending increased 2.6 percent (U.S. Department of Commerce, 1984, p. 16). The tilt toward military spending is also reflected in the fact that the industrial production index for all equipment rose by only 0.7 percent in 1983, while the sub-component for defense and space equipment rose by almost 9 percent (*Economic Report*, 1984, p. 269). Two other factors, also essentially Keynesian, contributed to the recovery. These were, first, lower interest rates which fell in late 1982 and early 1983, leading to a surge in spending for housing of 31.4 percent in the first quarter and 65.9 percent over the year. Finally, consumers reduced their rate of saving, which helped to boost consumer spending during 1983 by 4.5 percent (*Economic Report*, 1984, pp. 226–227). Thus the investment boom which got under way in late 1983 and continued into 1984 was not caused by supply-side factors. Rather, it resulted from the cumulative effect of an expansionary fiscal policy, a surge in housing, and an increase in consumption spending.

A concluding comment

The events reviewed in this paper show that both the recession and the recovery were the result of Keynesian and not supply-side factors. This was not the intent of the administration, but it is the way things turned out. The legacy of this administration's policies has not only been a recovery from a devastating recession, but a deficit which has reached unprecedented levels under high employment conditions. We are now clearly in new and uncharted territory. At the very least the actions of the administration have foreclosed the possibility of using fiscal policy again to deal with any future recession. It is impossible to see how any future administration of whatever political persuasion could propose

tax cuts or major spending increases—including higher social spending—as a way of coping with a new recession. This is the supreme irony: unintended Keynesian consequences have shut the door on future Keynesian actions.

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