

The Economy in Perspective

On the outs ... It has long been conventional in politics to portray oneself as an outsider. At one time, referring to a government official as an insider was a supreme compliment, but when the public became dissatisfied with government's performance, insiders recognized that they carried too much baggage. Insiders then campaigned as outsiders, but little actually changed.

When the insiders ran government, they never seemed sufficiently bothered by persistent budget deficits or generational fiscal imbalances to endure the short-run pain required for the long-run gain. They devised plans to curb the imbalances, but always scheduled the pain to occur in the outlying years, beyond the next election. Successive waves of outsiders came to Washington to reverse that result, only to become next year's insiders.

In the U.S. fiscal arena, the electorate now seems to have developed such an appetite for change that many ideas previously regarded as out-of-bounds are finally receiving serious attention. Although a concrete federal budget accord remains elusive, the broad outlines of an agreement are taking shape. In some fashion, the growth in spending on entitlement programs will slow down. The government will offer fewer services and outsource others.

The tax side of the equation will not be forgotten. It is far too soon to think that the progressive income tax system will be swept away, but alternatives such as the flat tax and consumption tax are no longer dismissed as politically outrageous. In fact, these ideas are likely to receive more serious scrutiny in the next several years than ever before. Even funding Social Security through individually managed investment accounts, instead of through a government fund invested in Treasury securities, will likely get a hearing.

Although congressional reformers are turning the budget process inside out, they may soon attempt to revise some aspects of monetary policy. Congress amended the Federal Reserve Act in 1977 to require the central bank to promote maximum employment, stable prices, and moderate long-term interest rates. The following year, through the Full Employment and

Balanced Growth Act, Congress required the Fed to report semiannually on its projections for economic output, the price level, and the level of unemployment, as well as to announce its plans for the growth of money and credit in the year ahead.

Although inflation has been trending downward since the early 1980s, it is not clear how much, if any, of the credit belongs to the legislative framework crafted nearly 20 years ago. At certain times during this period, knowledge of the future money supply would not have helped to predict anything. Moreover, many scholars have pointed out that by requiring the Fed simultaneously to promote several outcomes that may conflict, Congress is not providing enough direction to the monetary authority. A reasonable conclusion is that the Fed's recent outstanding inflation performance has been achieved largely independent of the existing statutes.

Now a group of outspoken lawmakers, led by Senator Connie Mack, proposes to out-and-out discard the Full Employment and Balanced Growth Act. As introduced in the Senate last September, the Economic Growth and Price Stability Act of 1995 would direct the Federal Reserve to promote price stability as its primary long-term goal. References to maximum employment and moderate long-term interest rates are stripped out to enable the Fed to focus more clearly on the price stability objective when it formulates and implements monetary policy. The bill also directs the Fed to establish a numerical definition of price stability and to report to Congress semiannually on its plans for achieving that objective.

It remains to be seen how much support this effort will eventually garner, and what changes may prove necessary to gain enactment. As the budget battle illustrates, when various interest groups seek to outwit, outflank, and outsell one another, the process can get out of control. But the potential gains from a stronger legal mandate for price stability justify the struggle. To prevent inflation from once again becoming out of sight, it is best to keep infeasible objectives out of mind.