environment for months," says Cotton's campaign manager, Justin Brasell. Just as Cotton announced his candidacy last August, Pryor put out a negative ad that accused Cotton of "blind ambition." By April the two campaigns and independent political organizations had already combined to spend about $8 million in TV ads, according to the *Washington Post*. The election could turn on personal details, such as the fact that Cotton just got married and Pryor just got divorced. That's what happened a dozen years ago, when Pryor ousted Republican senator Tim Hutchinson, who had left his wife and married a former staffer.

If nothing else, every Arkansan with a television soon will know about Pryor's voting record, which includes a decisive vote for Obamacare. That puts him in lockstep with many of his fellow Democrats in D.C., but not with Democrats in Arkansas: Mike Ross, a Democrat seeking the governorship, voted against Obamacare as a congressman.

Pryor, for his part, will knock Cotton's record, which includes votes against the farm bill (Cotton condemns it as "a food-stamp bill") and in favor of Representative Paul Ryan's budget plans. An anti-Cotton website sponsored by Pryor's campaign portrays Cotton as waging a political war on seniors and women.

"I want to focus on the biggest problems," says Cotton. "We have a debt crisis and a fiscal crisis in programs like Medicare. Paul Ryan is the face of reforms we advocate in the House. Who is that in the Senate?" Cotton casts himself as running against a single senator as well as a Democratic majority: "We pass a lot of good legislation in the House, but it goes to die in the Senate—or not even in the Senate, but on Harry Reid's desk, so that senators like Mark Pryor don't have to vote on it."

At a time when Republicans seem more libertarian and skeptical of foreign entanglements than ever before, Cotton is a hawk on defense and foreign policy. He wants to boost the Pentagon's budget and to project American power. Last September, he and Representative Mike Pompeo (R., Kan.), a fellow Army veteran, co-authored a *Washington Post* op-ed that urged Republicans to support "decisive, effective military action" against the Assad regime in Syria. He labels Edward Snowden "a traitor." He endorses the National Security Agency's cellphone surveillance and thinks that conservatives who oppose it are mistaken. "The story came out close to the revelations about the IRS and its punishment of conservative groups, and a lot of people conflated the two," he observes. "But they're very different. Lois Lerner of the IRS is a full-blooded partisan. The NSA is a military organization staffed by career officers who act in accordance with the law."

Cotton compares the Republican opportunity of 2014 to that of the Democrats in 2006. "When they won, it prepared the ground for Barack Obama to win." If Republicans keep the House and capture the Senate, he says, they'll be able to pass conservative legislation: "The president can sign it—or he can veto it and elevate the issue." Cotton adds that in 2016, Republicans may have a presidential nominee who is noticeably younger than the Democratic presidential candidate. "This will be the embodiment of a party with fresh ideas for the future, as opposed to the hidebound, stale, and decades-old policies of Obama and his successors."

The congressman clearly hopes to join this GOP youth movement. Between now and November, he'll try to persuade voters to agree with the buttons that Baxter County Republicans passed out at their latest Lincoln Day Dinner: "I'm picking Cotton." NR

The Right Goal For Central Banks

When the target is nominal, results are phenomenal

BY DAVID BECKWORTH & RAMESH PONNURU

A GLOBAL economic crisis may be painful, but it can provide some useful lessons. Countries recovered from the Great Depression in the order that they exited the gold standard of the time, which is a major reason most economists no longer favor that monetary regime. The turmoil of the last few years has followed a pattern as well: The more a country's central bank has done to keep nominal spending growing at a steady rate, the better that country has done. This international experience adds to an already-strong theoretical case for keeping nominal spending—the total amount of money spent in an economy—on a predictable path.

By definition, nominal spending is equal to nominal income (the total amount of money made) and to the size of the economy. The case for stabilizing the growth of that number starts with the understanding that central banks can't fix everything that ails an economy and shouldn't try. They cannot change its productivity or population growth, and therefore cannot change its long-term rate of economic growth. If regulations have made labor markets rigid, or rotten schools have yielded unskilled workforces, or property rights are insecure, central banks cannot overcome those problems.

What a monetary system can do is provide the stability to facilitate economic exchange. If a unit of money swings wildly in value, it will not be able to serve that function. Many people have therefore concluded that central banks should above all try to achieve price stability, fixing the average price level or letting it rise at a low and steady rate. To follow this rule rigidly, however, would require the central bank to act perversely in some instances.

A negative supply shock—say, a tsunami, or a disruption in oil imports—will lower real income and raise prices. If the central bank lowers the money supply to prevent the price hike, it will contract the economy further and thus magnify the impact of the shock on real income. Similarly, the central bank will have to greet a positive shock inappropriately, by raising the money supply to keep prices from falling when the economy is already booming.

Targeting nominal spending avoids these pitfalls. If the Fed were trying to keep total dollar spending growing at a 5 percent rate each year, for example, it would not need to loosen or tighten in response to supply shocks. Such shocks would alter only the *composition*

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of spending, with positive ones translating into more goods and services at lower prices. To stay on target, the central bank need respond only to shifts in the demand for money balances. It has to increase the money supply when people are more inclined to hold money balances—when, for example, they are scared of economic trouble and want liquid assets—and decrease the money supply when they are rapidly spending money. To put it another way, the central bank must decrease the money supply when money is circulating quickly and increase it when its turnover or velocity is low. And the more markets expect spending to stay on its target path, the more stable velocity should be in the first place.

One reason to avoid slumps in spending is that most debt contracts are written in money terms. Less spending means less income. So in our dollar-based economy, dollar-denominated debts—like mortgages—become much harder to service than people expected when they contracted them. A reduced and uncertain path of future spending also depresses asset prices, since the latter are based on the former. That's a double whammy for homeowners, and it becomes a triple when people start abandoning their houses in response.

Falling nominal spending wreaks havoc in other ways too. People are strongly resistant to cuts in how much money they are paid, far more than they are to real pay cuts brought about by inflation. So when less money is coming in, workers have to be let go.

This theoretical case implies, first, that central banks should try to keep the total amount of money spent growing steadily; second, that when they go off path in one year they should try to make up for it in the next, to keep long-term expectations on track; and third, that they should announce the policy. No central bank has yet taken all of these steps, and especially the third. Some central banks have, however, kept nominal spending growing at a relatively steady clip even without making that result an explicit goal.

Consistent with the theory, their economies have shown greater stability than those of central banks that pursued different policies. Israel and Australia, where money spending has stayed on its trendline, have been relatively unscathed by the economic crisis. The United States experienced a "great moderation" when the Fed kept nominal spending stable, calamity when it let it drop, and a weak recovery when it took halting efforts to resume its growth. The European Central Bank has not taken even those efforts—it has actually tightened money in some instances in the midst of the slump—and the eurozone's performance has been the worst of the bunch.

These different paths can be seen in Figure 1, where the blue line shows nominal GDP—a measure of total money spending—and the dashed black line shows its natural trend. The figure reveals that the Israeli and Australian central banks kept nominal GDP close to trend in the years during and after the crisis. The Fed, on the other hand, allowed a sharp fall in money spending and has muddled through ever since. Its first round of quantitative easing arrested the fall, and subsequent rounds have increased nominal GDP, but it has returned only partway to trend (based on statistics from the Congressional Budget Office). A far greater departure has occurred in the eurozone, where the ECB has allowed a gap between actual and trend nominal GDP to emerge and grow.

Figure 2 shows the changes in the money supply and velocity that lie beneath these nominal-spending paths: how far the money supply and velocity deviated from their trend. In the years leading up to the crisis, all the central banks were conducting monetary policy in a manner that caused changes in the money supply to roughly offset changes in how often money was used. That's why nominal GDP closely fits the trend in all the economies during this time, as seen in Figure 1. For Israel and Australia, this process continued through the entire period. In the United States the offsetting mechanism broke down in 2008–09. The eurozone has not yet fully recovered from a similar breakdown that occurred in 2010. (The breakdowns are highlighted by gray bars.)

In the U.S. and the eurozone, the economy seems to have paid a price for central banks' failures to maintain monetary stability. From 2008 to 2013, the economy of the United States grew 1 percent on average after inflation each year; the eurozone shrank 0.4 percent each year. Meanwhile Israel grew 3.5 percent on average and Australia 2.5 percent. These nations' unemployment rates also moved in the way theory would predict given their monetary

Figure 1

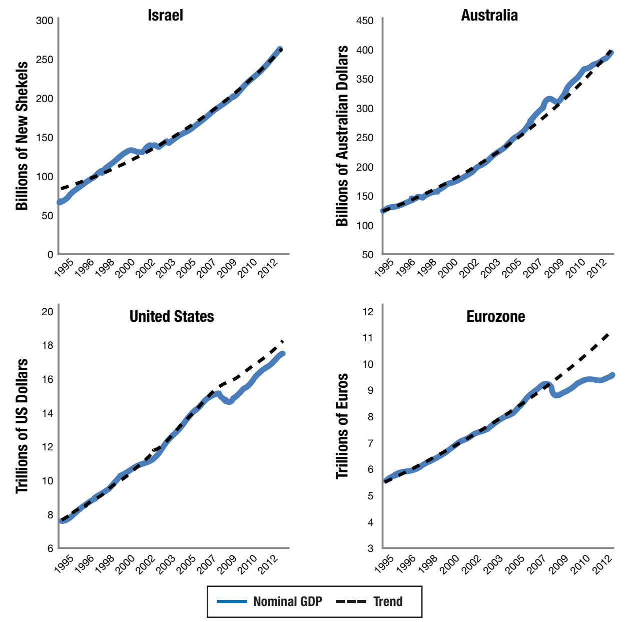
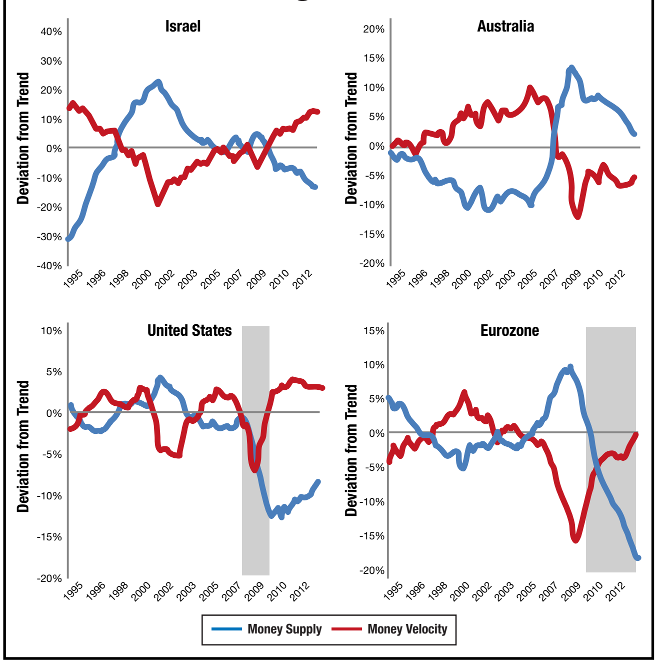


Figure 2

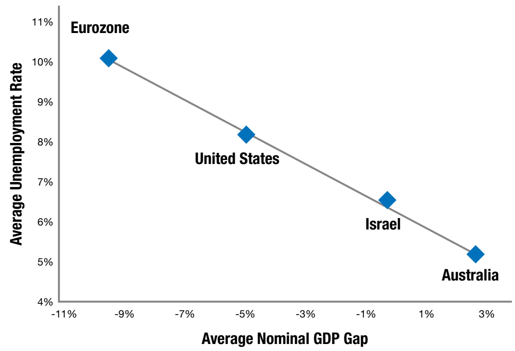


policies. Figure 3 plots the average unemployment rate for each of these economies during this time period against the average nominal GDP gap (the difference between actual and trend nominal GDP). The resulting scatterplot shows a strong negative relationship. It implies that for every percentage point that nominal GDP fell below its trend, the unemployment rate rose by almost half a point. The closer spending stuck to its trend, in other words, the better off was the economy.

Maintaining stable nominal spending was not a trivial accomplishment for Israel and Australia. They too were buffeted by the global economic shocks of 2008, and Australia had a housing boom and a surge in household debt. Both countries were able to keep money spending stable by aggressively easing monetary policy. The Israeli central bank cut interest rates in the fall of 2008 and later intervened in the foreign-exchange market to keep the shekel competitively valued. The Australian central bank also cut interest rates, acting in advance of the crisis. This preemptive action signaled to the public that the central bank of Australia would do whatever stabilization took. This reassurance seems to have kept money velocity stable, so Australian monetary authorities did not need to resort to monetary injections as much as other countries have. The central bank of Australia has not had to rapidly expand its balance sheet. Nor have interest rates had to stay as low in Israel and Australia as they have in the U.S. and the eurozone.

This record suggests that Europe and America might have had far milder recessions had their central banks acted more like their counterparts in Israel and Australia. Inflation targeting may have led the U.S. astray: The Fed refrained from taking the expansionary move of cutting interest rates in September 2008, when

Figure 3: Nominal GDP Shortfall and Unemployment 2008:Q1–2013:Q4



the economy and financial system were crashing, because it was concerned about inflation—which had been induced by a supply shock. Even at that, some observers have faulted the Fed for being too expansionary. They should be happier with the record of the ECB, which has consistently followed a tighter policy. The results suggest how misguided their line of thinking is.

The more closely a central bank has approximated a policy of keeping nominal spending on a predictable path, the better the economy served by that bank has done. That path would be even more predictable if central banks would explicitly adopt that goal. Both theory and experience suggest that they should, so that the economic pain of the last few years will not have been entirely in vain. **NR**

The Tory Imagination

Reflections on the limits of Whiggery

BY MICHAEL KNOX BERAN

EARLIER this spring I was trying to write an article about Francis Bacon, a chief architect of our modern prosperities, when I went into New York to hear Bach's *St. Matthew Passion*. Bach's hero is a philosopher who said that man cannot live by bread alone; Bacon ordained a revolution that has enabled us to make—an inconceivable number of different kinds of bread.

I don't know whose version of truth was keener, but certainly in New York on that spring afternoon Bacon's influence was more palpable. Bacon preached the virtues of the inductive method, which, by disclosing "all that is most hidden and secret in the world," would "endow the life of man with infinite commodities." And he was right: The revolution he foresaw, after it was given practical effect by the Whig thinkers and statesmen of a later age, has so far transformed our material life that when asked for forecasts of what is to be, we can but repeat Bacon's own words—that the "knowledge which we now possess will not teach a man even what to wish."

If I sought Bacon's monument, I had only to look about me as I rode the subway up from Grand Central. One straphanger was indeed reading a newspaper, but most of my fellow passengers were busily fingering devices that, though undreamt of a decade or two ago, offered them instant initiation into quantities of knowledge vastly greater than that in all the libraries in the world in Bacon's time—or might have done, if apps like Flappy Bird and Bridge Baron didn't get in the way.

Bacon practically invented our modern Whig world of progress and commodity, yet he saw that the new empire of inductive truth would have vexations of its own. Truth, he wrote, "is a naked and open day-light, that doth not shew the masques and mummeries and triumphs of the world, half so stately and daintily as candle-lights." It "may perhaps come to the price of a pearl, that sheweth best by day, but it will not rise to the price of a diamond or carbuncle, that sheweth best in varied lights."

I got off the subway and walked up Lexington Avenue to St. Jean Baptiste, where in the April sunshine black-stoled choristers were going into the church, exchanging the "naked and open day-light" Bacon identified with truth for the shadow and candlelight he associated with the pleasures and deceptions of the imagination:

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