BAD IDEAS

CONFIDENCE GAMES & DEMAND-SIDE DANGERS

BY BRIAN S. WESBURY

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.

—John Maynard Keynes

Lord Keynes wasn't right about much, but his remark above was certainly on the mark. Two mistaken economic ideas are having a direct impact on the U.S. and the world following the Sept. 11 attacks. Left standing, they could have a powerful negative impact on the U.S. economy in the years ahead.

The first was nicely expressed by Michael Lerner, editor of the progressive Jewish magazine *Tikkun*, during an interview on the PBS NewsHour in early October. He said that the U.S. "has five percent of the world's population and twenty-five percent of the world's wealth. Our wealth is directly related to other people's poverty, and when that's the case in the world, then you're going to find a great deal of anger and resentment."

We have all heard this argument before, usually arguing for redistribution of wealth, but rarely as a justification for mass murder. The fallacy underlying this theory is that the accumulated wealth of the world is a "zero-sum" game. Lerner, once a key advisor to Hillary Clinton, believes that poverty around the world is caused by U.S. success at creating wealth.

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The second wrong-headed idea making the rounds is that declining consumer confidence is the cause of our current economic difficulties. Major business publications and leading economists routinely refer to confidence as a "critical" economic indicator. Even the President has gotten into this debate by saying, "we need to provide more tax relief to individuals to boost consumer confidence."

Most people wouldn't realize that these two equally misguided ideas have their roots in the same demand-side philosophy that Keynes fathered. It argues that consumer demand is the catalyst for economic growth, the gas in our economy's tank. But as the great early 19th-century French economist Jean-Baptiste Say told us many years ago, "Supply creates its own demand." The Wesbury corollary: "Demand creates nothing."

Think of it this way. No matter where you go in the world, consumers have an infinite demand for goods and services. Even Osama bin Laden has an insatiable demand for terrorist capabilities. But these demands cannot be satisfied until production takes place.

Production is the process of creation. It combines ideas, faith and a willingness to take risks to develop goods and services that others need, want or desire. It is a near-mystical event that can only occur in an environment of freedom. And only in a free environment can most individuals find their true God-given talents and put them to use.

That is why countries that are free create more wealth than those that are not. Every year, the Heritage Foundation and the *Wall Street Journal* publish an Index of Economic Freedom, ranking the world's countries according to ten broad categories of economic freedom. See the map at right, and think about some of the implications.

The disparity of wealth between the U.S. and much of the rest of the world has nothing to do with the wealth of the U.S., but has everything to do with the continuing lack of freedom in so many places, even with the Soviet Union and its empire, long ago on the dust heap. When freedom does not exist and taxes, government spending and corruption are high, entrepreneurs and the process of wealth creation inevitably suffer.

Furthermore, the U.S. has no incentive to inhibit the creation of wealth by other countries. A wealthy nation is a potential trading partner and market for American goods and services. Wealth feeds on the success of others. A rational country would only want the best for every other country in the world.

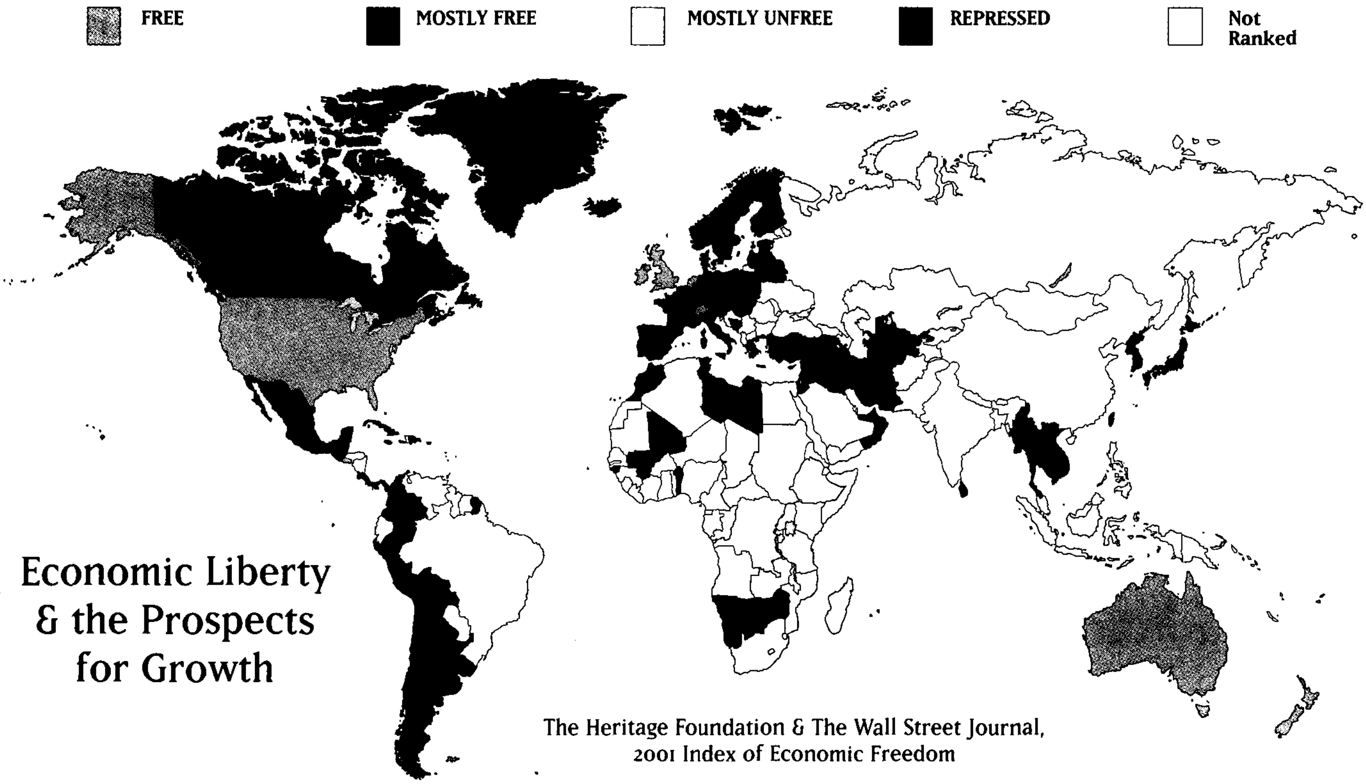
While not nearly as catastrophic an error, the idea that consumer confidence is the cause of our current malaise has its roots in similarly misguided analysis.

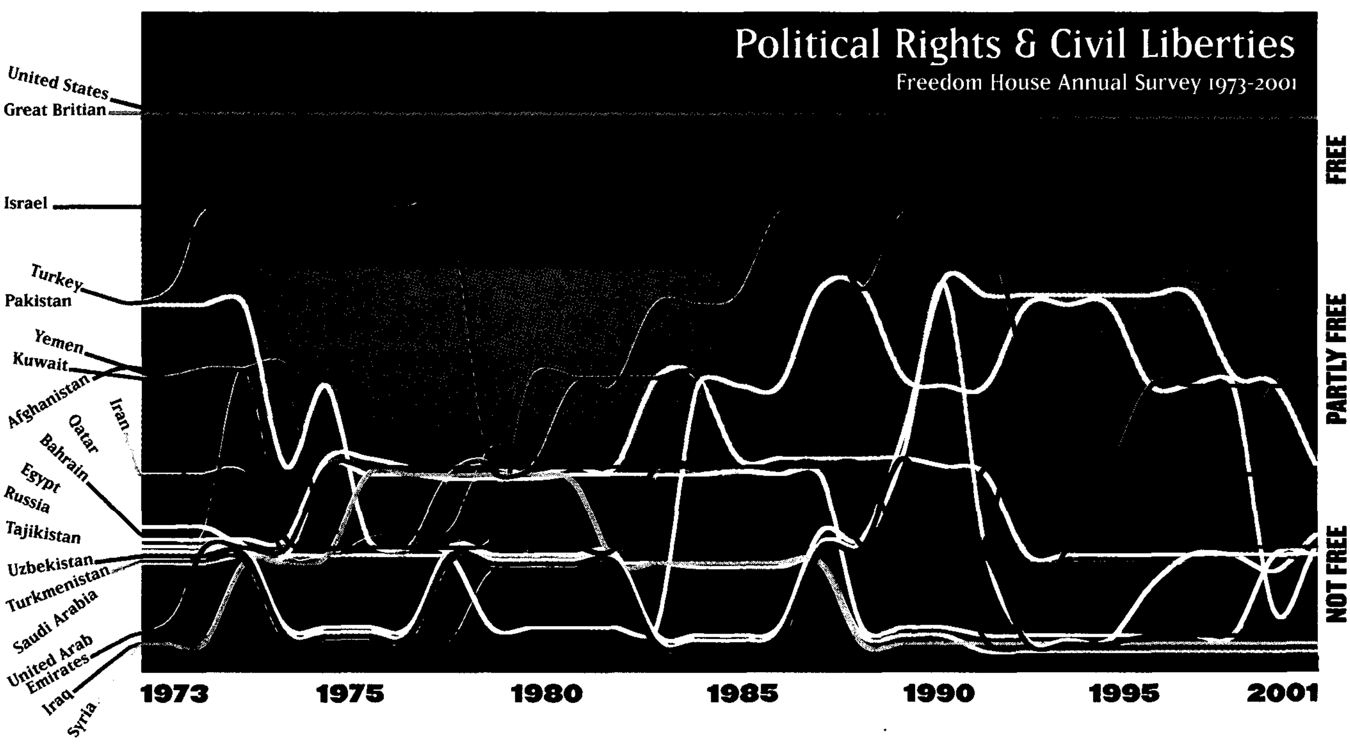
Everyone understands that since Sept. 11, fear of flying has hurt the airline and travel industries. But no matter what kind of tax rebate package Congress comes up with, of and by itself, it will not appreciably reduce that fear. In other words, confidence—or more to the point, lack thereof—related to terrorism is not an economic problem; it's a security problem. And until Americans feel safe again, they will make different choices.

If consumers spend less for travel, they will spend more on other things—flags, for instance, or gas masks, or who knows what else. As a result, overall spending levels should not deteriorate dramatically over the long-term just because of the attacks. Rather, the slowdown in consumer spending of recent months is rooted in—surprise!—the current recession; consumer confidence has fallen along with the rest of the economy. Confidence rises when the economy is growing and jobs are being created; it falls when the economy is weak and jobs are being destroyed.

Statistical models show that consumer confidence has virtually no predictive value as an economic forecasting tool. Plotting the Conference Board Current Conditions con-

The Freedom Factor





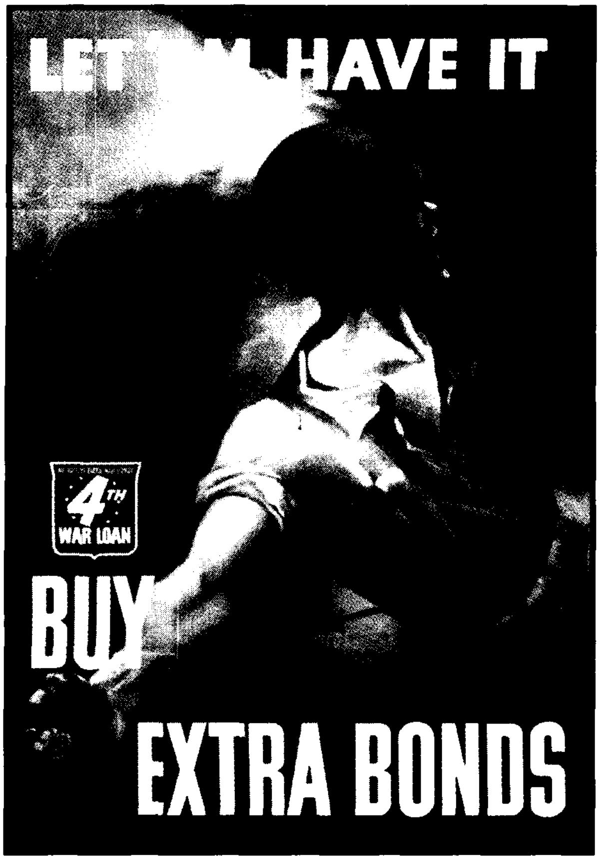
fidence index against real retail sales growth during the six months that follow produces a scattershot pattern: consumer confidence predicts just three-tenths of a percent of the subsequent change in retail sales. Looked at the other way, 99.7 percent of the growth in retail sales is determined by factors *other than* consumer confidence. Knowing this, why do economists and our nation's leaders still talk about confidence as if it were the Holy Grail of economics?

The answer is simple. Consumer confidence is a proxy for demand. Keynes believed that the problems of the Great Depression revolved around the lack of demand. He argued that if consumers were unwilling to spend, then government should do it for them. He went so far as to suggest that the government pay people to dig holes in the ground and then fill them back up.

While such spending would indeed create economic activity—as would scattering dollar bills—it could not have created new wealth. No new supply would have ever occurred. But governments tend to like this argument—it makes them the center of economic activity. It's a perfect economic theory to support more government involvement in all aspects of the economy and greater redistribution of wealth. It's easy to understand why liberals love this; what's harder to understand is why some in the Bush administration are now carrying the same torch.

President Bush has been masterful when it comes to dealing with the military, but he has missed the opportunity presented by a war-time bully pulpit to promote good economics. It's certainly hard to expect—or even detect—a great deal of supply-side stimulus from the tax bill that has been working its way through Congress this fall.

The creation of wealth is not zero-sum. Government redistribution is. The defunct economist, John Maynard Keynes, still has a strong grip on our nation's economic thinking. Not all the dangers in the world are obvious.



LET'S GET IT RIGHT

BOOT THE PENTAGON'S PERFUMED PRINCES

BY DAVID H. HACKWORTH

On D-Day during America's first strike in Afghanistan, the cross hairs of an unmanned Predator's air-to-ground missile were locked dead center on Mullah Omar's forehead. But just as the Taliban's *capo di tutti capi* was about to receive his one-way ticket to Paradise courtesy of U.S. technology, a military lawyer in Tampa, Florida shouted, "Cease fire!" And then his boss, General Tommy Franks, U.S. Central Command chief, chose to let this crazy call ride.

Talk about the twilight zone! Can you imagine what George Patton would've done if his legal beagle had dared to suggest, "Don't squeeze the trigger, even though you've got Adolph Hitler's head sitting on a rifleman's front sights!?"

Insiders say that when Defense Secretary Donald Rumsfeld got the word, he almost pounded his desk into toothpicks. But blinkered and bureaucratized military leaders who can't think out of the box must be making Rumsfeld lose it more and more frequently since he returned to the Pentagon for another tour, this time with the mission to boot that five-sided institution into the 21st Century.

Unfortunately, today's politically correct senior uniformed leaders were selected for their Kinder-Gentler-Global-Village bent. The result is that we're stuck with careerist, MBA types—I call them Perfumed Princes—who act more like corporate CEOs than warrior-leaders. Contrary to war-fighters of the past, they don't have the bold stuff to roll the dice and go for broke. Instead, they set up interminable risk-assessment safety nets—including rules of engagement tighter than a gunsmith's vice—to avoid taking any bullets to their careers. Meanwhile our warriors, our military assets and the citizens of this great land have never been so exposed.

Most of our conventional military fights are like a flabby fatso duking it out with a lighter, quicker opponent. At the same time, our forces are spread around the globe like Roman Legions, in unified commands such as General Frank's Florida-based CENTCOM. They're watching the current conflict on TV while less than ten percent of our muscle-bound force is actually involved in hunting down and taking out the bad guys.

Right after the 9/11 attack, our Germany-based two-division Armored Corps moved to Poland to practice "Hi-Diddle-Diddle-Right-Up-The–Middle"—a tank tactic of Patton's 57 years ago. Homages to WWII aside, the U.S. Armed Forces—with a total force, active and reserve, of about three million people—has more colonels than machine gunners, more

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