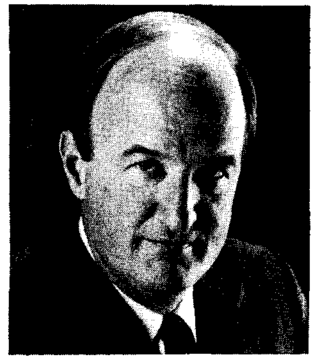

Is This the Age of Ignorance—Or Enlightenment?

"I am more and more impressed by my ignorance."

—Herbert Stein, "The Age of Ignorance," *The Wall Street Journal* (June 11, 1993)

Herbert Stein ought to know better. He was the chairman of President Nixon's Council of Economic Advisers and an economics professor at the University of Virginia. Today he's a member of *The Wall Street Journal*'s board of contributors and an American Enterprise Institute fellow.

Yet here he is filling up a valuable page in *The Wall Street Journal* proclaiming to the entire world that he knows very little, if anything. After reading three daily newspapers and numerous magazines, watching all the talk shows, and talking to dozens of "well-informed" people, he confesses complete ignorance about the budget deficit, taxes, the money supply, the stock market, and the war in Bosnia.

"I don't know whether increasing the budget deficit stimulates or depresses the national income. I don't know whether it is M2 or M1 that controls the level of spending. I don't know how much a 10 percent increase in the top rate of individual income tax will raise the revenue. . . . I do not know how to pick winning stocks."

The New Nihilism: The Bankruptcy of the Economics Profession

It wouldn't bother me if one lonely Ph.D. economist claimed ignorance of basic economics, but the amazing thing is that Herbert Stein is not alone. He reflects a strange new malaise in the economics profession, an eerie complacency about the burning economic issues of the day. Economists all along the political spectrum are eschewing responsibility for policy decisions or forecasting the future. Will interest rates rise or fall? Are we headed for another recession, more inflation, or both? Will the stock market go up or down? The answer is always the same: Who knows?

Robert J. Barro, Harvard economist and exponent of the New Classical School, seemed to take pride in his laid-back attitude about the economy during the 1991-1992 recession: "The questions I am asked most often these days are: Why is the economic recovery weaker than expected? How will the economy do over the next year? What should the government do to help? As a first approximation, the right answers to questions like these are: 'I don't know,' 'I don't know,' and 'nothing.'" (*The Wall Street Journal*, November 21, 1991)

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Not to be outdone is Paul Krugman, self-proclaimed Keynesian professor at MIT. He asserts that economists, including himself, don't understand why there are business cycles. Furthermore, economists "don't know how to make a poor country rich, or bring back the magic of economic growth when it seems to have gone away. . . . Nobody really knows why the U.S. economy could generate 3 percent annual productivity growth before 1973 and only 1 percent afterward; nobody really knows why Japan surged from defeat to global economic power after World War II, while Britain slid slowly into third-rate status."[1] Really? Mind you, this is the professor who won the John Bates Clark Medal, a prize given every two years to the most promising American economist under the age of forty. According to the dust jacket of Krugman's latest book, *The Economist* called him "the most celebrated economist of his generation." Hmm. . . .

Daniel Hausman, economics professor at the University of Wisconsin at Madison, wrote a massive volume on capital and interest and concluded with a straight face: "Economists do not understand the phenomena of capital and interest. They do not understand why the rate of interest is positive (and thus how it is that capitalism can work). They do not know how large-scale changes in the rate of profit will affect innovation."[2] And he's a specialist!

Economists as ignoramuses can best be summed up by John Maynard Keynes, the economist-king of the twentieth century, who declared in 1937, "The fact that our knowledge of the future is fluctuating, vague and uncertain, renders wealth a peculiarly unsuitable subject for the methods of classical economic theory. . . . There is no scientific basis on which to form any calculable probability whatsoever. We simply do not know."[3]

An Admission of Failure

In some ways, the New Ignorance school of economics is a welcome sign. In the 1960s, it was the New Arrogance school of economics. Forgetting Keynes' admission of 1937, the Keynesian technocrats claimed they had the tools to fine tune the economy, control inflation and ban the business cycle forever. Now, thirty years later, the establishment economists are finally admitting that their theories and policies have failed miserably. The profession has had a terrible record in predicting recessions, inflation, and stock prices, and their policy recommendations have made things worse, not better. As Hayek stated when he received his Nobel Prize in 1974: "We have indeed at the moment little cause for pride: as a profession we have made a mess of things."[5] By the 1990s, all the major schools of economics had failed, one way or another—Keynesian, monetarist, and Marxist. Alfred Malabre, Jr., former economics editor of *The Wall Street Journal*, appropriately calls today's economists "Lost Prophets," the title of his new book.

So it is fashionable today to plead naivete. But is ignorance a virtue? St. Paul didn't think so when he warned Timothy about intellectuals who are "ever learning, and never able to come to the knowledge of the truth." (2 Timothy 3:7)

The Standardbearers of Sound Economics

Among the many schools of economics, who carries the banner of truth? I believe that the best and the brightest thinking today is coming from the Austrians, the supply-siders, and other free-market scholars. Although some have fallen into the trap of "radical subjectivism," where everything is uncertain and unpredictable, most free-market economists have established objective principles of economic behavior, and can predict with considerable certainty the benefits of economic liberty and the ill-effects of government intervention, and how certain economic policies will affect output, prices, and stock markets.

Armed with these principles, let us see how well we do with the issues raised by the new nihilists. Herbert Stein says: "I don't know whether increasing the deficit stimulates or depresses the national income." Response: Transfers from the *productive* private sector to the *unproductive* public sector inevitably depress the national income.

Stein admits, "I don't know whether it is M2 or M1 that controls the level of total spending." Hasn't he read Adam Smith or Ludwig von Mises? Purchasing power is not determined by the money supply, but by productivity and output.

Stein declares, "I don't know how much a 10 percent increase in the top rate of individual income tax will raise the revenue." Hasn't Stein read the numerous studies demonstrating that the rich pay fewer taxes when marginal tax rates go up?

Finally, Stein confesses, "I do not know how to pick winning stocks." Instead of watching all those talk shows, why doesn't Stein follow the work of Peter Lynch, Warren Buffett, John Templeton, Value Line, and other analysts who know how to pick winning stocks?

Now onto Professor Barro, who didn't know why the recession hit in the early 1990s and where the economy was headed. The answers are pretty clear: The economic recovery was weaker than expected in 1991 because of a massive tax increase passed in 1990, on top of a tight money policy. The economy began recovering in 1992 due to the Fed's easy money supply. What should the government do to create a permanent recovery? Cut taxes and business regulations immediately, across the board.

Professor Krugman doesn't understand the business cycle? The Mises-Hayek theory is a good starting place, but unfortunately MIT has had a long tradition of ignoring the Austrian school. Daniel Hausman could get some answers there too. Why are interest rates positive? Time preference, declared Menger, Böhm-Bawerk, and Mises many decades ago. These Austrians specialized in the theory of capital and interest, and the role of the entrepreneur. Technological breakthroughs increase productivity and wages, and higher profits stimulate innovation by providing more capital for research and development.

Paul Krugman doesn't know how poor nations become rich? He should investigate the economic miracles of southeast Asia. The common denominators for Singapore and Hong Kong are a strong, stable, and lean government, low taxation, high levels of saving and investment, open markets, and minimal concern with income distribution. (*Forbes*, April 11, 1994) Could these reasons also help explain Japan's post-war success story? Pro-growth government, high saving rates, low taxes on investment, emphasis on training, and quality improvements. Or why Britain stagnated? High taxes, price and exchange controls, excessively powerful labor unions, bureaucracy, and welfarism.

In short, this isn't the Age of Ignorance. It's the Age of Enlightenment, for those who are willing to open their eyes and see. Unfortunately, too many of today's economists are blind guides. "For this people's heart is waxed gross, and their ears are dull of hearing, and their eyes they have closed; lest at any time they should see with their eyes, and hear with their ears, and should understand with their heart, and should be converted, and I should heal them." (Matthew 13:15) □

1. Paul Krugman, *Peddling Prosperity* (New York: W. W. Norton, 1994), pp. 9, 24. His previous book, *The Age of Diminishing Expectations*, came out in the early 1990s, just when Third World nations began throwing off socialism and Marxism, and sensed rising expectations for the first time.

2. Daniel M. Hausman, *Capital, Profits, and Prices* (New York: Columbia University Press, 1981), p. 190.

3. John Maynard Keynes, "The General Theory of Employment," *Collected Writings of John Maynard Keynes* (London: Macmillan, 1973), p. 114. This essay originally appeared in *The Quarterly Journal of Economics* in 1937.

4. Friedrich A. Hayek, "The Pretence of Knowledge," Nobel Prize Lecture, reprinted in *The Essence of Hayek*, ed. by Chiaki Nishiyama and Kurt R. Leube (Stanford: Hoover Institution Press, 1984), p. 266.

A REVIEWER'S NOTEBOOK

RECLAIMING THE AMERICAN DREAM

by John Chamberlain

Richard Cornuelle, author of *Reclaiming The American Dream*, subtitled, *The Role of Private Individuals and Voluntary Associations* (Transaction Publishers, New Brunswick, N.J., 1993, 258 pages, $19.95 paperback), is the man who restored Alexis de Tocqueville to his rightful place in American history.

Cornuelle had worked as a young man for Garet Garrett. A good observer, he had noticed that it had become fashionable to speak of American life in terms of only two sectors: the public, a euphemism for government; and the private, or commercial sector. The division seemed somehow wrong. Cornuelle discovered the inadequacy of the two-part division by reading Tocqueville's *Democracy in America*, in which the Frenchman marveled about our tendency to handle public business through associations that had no connections with the state. Americans founded associations to give entertainments, to found seminaries, to build inns, to construct churches, to diffuse books, to send missionaries to the Antipodes, and to establish hospitals and schools.

The omission of the independent sector had resulted in a tendency to shuffle off work onto government. It ignored the Kiwanis, Rotary, Civitan, and Lions clubs, as well as the Chambers of Commerce, and some 3,500 independent private hospitals. "There were," so Cornuelle observed, "1,357 private colleges and universities, and enrollments in them went up faster than in the public schools."

There is something of a contradiction in Cornuelle's lament that conservatives failed to have programs or that liberals had some of the programs that they did sponsor. Cornuelle should be happy that the American dream worked for a hundred years. Our founders had taken pains to design a government with limited powers. Sometimes, this power resulted in a crazy intensity decorating the walls of Alcatraz Prison or in the frivolity of groups organized for treks in classic cars, or even in learning to be clowns. But the independent sector, as Cornuelle put it, is a kaleidoscope of human action, which takes a thousand forms. Sometimes the driving power of the independent sector may seem weak, but the demand to serve is none the less a compelling drive. "We see the services and their many alloys," says Cornuelle, who is satisfied to observe that "145,000,000 Americans have some form of health insurance."

Cornuelle sends me a copy of his revised book with the remark that, "Here it comes again." (*Reclaiming The American Dream* was originally published in 1965.) He says in his afterword that the Reagan mission was not to repeal the welfare state but to preserve it and to accept debt or inflation for taxation.

This was all true enough for the moment,