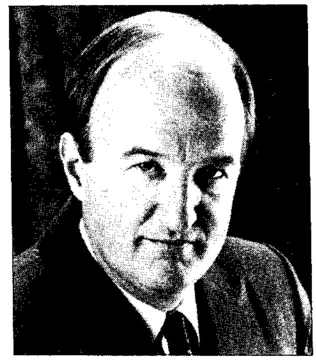

The Perversity of Wall Street

"Strong employment gains tend to be negative for both stocks and bonds."
—Marty Zweig, *The Zweig Forecast*
July 29, 1994

GDP rises 5 percent? The market dives! Unemployment jumps to 7 percent? Hurray, bonds rally!

Why is it that good news on Main Street is bad news on Wall Street? And vice versa? Financial analysts and institutional investors are convinced that strong economic performance is bad for the financial markets. High economic growth or good jobs reports can only mean higher inflation down the road, they assume, which in turn will force the Federal Reserve to tighten money and raise interest rates. Presto, stocks and bonds decline on good economic news.

The real culprits, says *The New York Times* ("Why America Won't Boom," June 12, 1994), are the bondholders of America. "The American economy is governed by the bond market," Louis Uchitelle writes in *The Times*, and "the confederation [of bondholders] has ruled in recent months that the economy should lose strength, not gain it." Another recession may not be good for the country, but it's great for bondholders as interest rates decline and bond prices skyrocket.

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No wonder Wall Street suffers from a tarnished public relations image.

Surprisingly Good News

Fortunately, there is good news for both Wall Street and Main Street. Believe it or not, the United States can enjoy a booming economy without interest rates rising. In fact, interest rates can decline under the right circumstances, even as the demand of business expansion increases.

Latin America and many other emerging market economies have proven that economic growth and lower interest rates can go hand in hand. In Mexico, Chile, India, and many other rapidly developing nations, interest rates have declined in the face of strong economic expansion and a rising standard of living. How? While pursuing anti-inflation policies, their governments have cut tax rates, privatized government services, reduced tariffs, welcomed foreign capital, and deregulated business. In addition, some countries (such as Mexico and Argentina) have eliminated capital gains taxes altogether, thus encouraging saving and investing.

The Trouble with Easy Money

Unfortunately, the United States and other industrial countries are not following these sound principles of free-market capitalism. Instead, they are relying primarily on "easy money" policies to stimulate economic growth. If a strong economic recovery is spurred by easy-money/low-interest rate policies, the fear of inflation is very real when the economy heats up. Hence, interest rates tend to rise once an inflationary boom gets started.

That is precisely what has happened in the United States during the early 1990s. To get the economy moving again, the Fed pushed short-term rates down to 3 percent, encouraging millions of savers to switch out of bank deposits and CDs and into stocks, bonds, and mutual funds. Obviously, this artificially low interest rate strategy could not last forever. As the Austrian economists point out, an inflationary policy will eventually *raise* interest rates and cut short the recovery. A boom must lead to a bust. In the first half of 1993, interest rates started increasing in the face of rising inflationary expectations.

Prosperity by Other Means

The key is to spur genuine economic growth by means other than easy money and artificially low interest rates. How then? By encouraging higher rates of saving and capital formation. This could be accomplished very easily by reducing or eliminating taxes on businesses, savers, and investors. A sharp reduction in the capital gains tax rate and the corporate income tax rate would do wonders for economic growth without raising interest rates. So would exemptions on interest and dividends, or expanding tax-deferred retirement programs.

As a result, the supply of saving and investment capital would expand, putting downward pressure on interest rates. Again, as the Austrian economists demonstrate, a longer-term time preference, as reflected in higher rates of saving, tends to drive interest rates lower.

Then, we could put an end once and for all to this myth on Wall Street that a booming economy necessitates higher interest rates.

Someday, when the United States gets its act together, we can look forward to this headline: "GDP jumps 10%. Dow skyrockets to 30,000, surpasses Nikkei." □

BOOKS

Are There Too Many Lawyers? And Other Vexatious Questions

by Joseph S. Fulda

Foundation for Economic Education • 1993 • 121 pages • $14.95 paperback

Reviewed by David M. Brown

In the title essay of this new collection, the author considers not merely whether we have "too many" lawyers, but what it is about *law* itself that makes it a different commodity than, say, shoes.

We wouldn't normally worry about whether there were too many shoemakers on the market (so long as an overproduction of shoes isn't being subsidized by the Shoe Ministry). But a proliferation of lawyers may signal a deeper problem: a problem with the legal system itself, with the license for abuse it permits certain participants, like plaintive plantiffs. As Fulda writes, "legal services are fundamentally different from other services, simply because lawyers must use the law—the State—to give plaintiffs the property of defendants. Today's plaintiffs' bar is expert at using the law to attain wealth by what Albert Jay Nock called 'the political means' rather than 'the economic means'—i.e, by the redistribution of existing wealth, rather than the creation of new wealth."

This kind of probing of essentials is, of course, what we expect from *The Freeman*, the journal from which most of these pieces are taken. The essays divide primarily into two sections: a review of the foundations of liberty and the libertarian psychology, and the practical application of individualist principles to current policy questions. A third section considers issues of "narrow ethics."

Libertarian readers will be inclined to nod their heads in agreement for the most part over the basic theory. As usual, it's when theory gets applied that the most evident disagreements between philosophical compatriots emerge.

For example, one can agree with Fulda's view in "Why Are There So Many Social Issues?" that our schools should not be an arena for governmental mediation of conflicting educational values. Certainly all schools should be private, free-market entities, not a vast agglomerated public domain subject to coercively uniform standards. We really wouldn't need to debate prayer in the schools if parents had real liberty to pick and choose among competitive schools with freely developed charters.

But . . . we do have a genuine problem now, which Fulda admits his perspective cannot "reach"; namely, what do we do about such value conflicts *now*, as they have been engendered and perpetuated within the existing public educational system? We can agree that the conflict may be insolvable under present circumstances, while yet noting it still needs to be *dealt* with. Do we tell parents, "Sorry, just keep squabbling until everything is privatized?" The courts have to make *some* kind of ruling when they get these cases, after all. A philosophy of individualism and freedom should be able to help us out here to some extent. Moreover, social issues tend to be a little more fundamental and persistent than I think Fulda allows for; the conflicts are not simply generated from scratch by the government's involvement. They are often what provoked that involvement in the first place.

Probably the most controversial essay in the collection will be "Abortion: Is Pro-Choice a Libertarian Position?" This is an issue that has seen endless wrangling in all ideological camps. Fulda rebukes the "pro-choice" position for ignoring the truth that freedom of action entails responsibility for the consequences of one's acts. And he calls abortion an "act of coercion," a claim that has been less mildly asserted in other quarters. Now, granted, the right of freedom, if it is to remain coherent, must incorporate a ban on initiatory coercion against others. But the question is, *which* others? The