The
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The Folly of Stimulus

Christopher Westley

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Years of spending, inflating, taxing, and redistributing has left the US economy teetering on a recession that our best and brightest—meaning the ones who created this mess—claim requires a multibillion-dollar economic-relief package to quell fears, promote confidence, and spur recovery.

And, one might add, to keep things calm past election time, which is the real purpose of this bipartisan effort to "stimulate" the economy out of recession fears.

It leaves you wondering about what happened to the 1990s boom, a credit-fueled expansion also influenced by a peace dividend. The end of the Cold War produced a floundering federal government that lost its rationalization to grow and found itself unsure of its purpose, thus promoting an era of relative peace and prosperity.

Oh, how things changed in the 2000s, with new monsters to destroy and new justifications for centralized power! Table 1 lists just a few of the results of these policies, and it explains why the presidential candidates are all about the change-change-change! Unless you are long on gold or short on bank stocks, who benefits from the status quo?

The difference between the 1990s and the 2000s expansions is that while the former relied less on the fiscal tool of debt, fiscal and monetary tools defined the latter—economic interventionism's double whammy of debt expansion and money creation. Both tools are preferred by politicians who receive short-term benefits from growing the government while not forcing the current generation to pay for it.

Both also are preferred forms of taxation because they shield the full cost of government from current voters. Debt shifts tax obligations to future generations, while inflating the money supply is a pernicious consumption tax because it makes you pay for big government in the form of higher prices.

The end result, however, is an unsustainable boom followed by an inevitable bust, the beginning of which we are starting to see right now. Yet, the solutions being aired by establishment thinkers on the Left and the Right call for more of the same. Boys and girls, the word for 2008 is "stimulus"—a new round of debt and inflation to forestall the inevitable correction.

All plans are still murky, but the total size of the economic stimulus package should fall between $125 to $2,000 billion in tax cuts, targeted spending, and rebates. ⇨

Table 1: Miscellaneous Trends, 2000–2007

	2000	2007	Change (%)
US Population	281.4 million	301.6 million	+7.18
Tax Revenues	$2.025 trillion	$2.54 trillion	+25.4
National Debt	$5.67 trillion	$9.01 trillion	+58.9
Budget Deficit/Surplus	$236.2 billion	-244.2 billion	-196.7
Unfunded Liabilities (Social Security, Medicare, Medicaid)	$33 trillion	$53 trillion	+60.6
MZM Money Supply on Dec. 31	$4.697 trillion	$8.105 trillion	+72.6
Monthly Inflation in December	3.38%	4.08%	+20.7
Military Spending	$294.5 billion	$439.3 billion	+49.2
Department of Agriculture budget	$75.1 billion	$88.7 billion	+18.1
Farms	2.167 million	2.09 million*	-3.5
Dollar-Euro Exchange Rate on Dec. 31	1.062	.6794	-36.0
Gold Price on Dec. 31	$272.15	$833.20	+206.15
Citigroup Stock on Dec. 31	$51.06	$29.44	-73.4
Archer-Daniels-Midland Stock on Dec. 31	$15.00	$46.43	+209.5
Gasoline Price (US Regular) on Dec. 31	$1.38	$3.02	+118.8

* Most recent figure for 2006

Check your mailbox. You may find a government check between $600 and $1,600 sometime before the April 15 tax deadline. One certainty is that we'll know the details soon.

Let's recall the economic justification for such policies. They are based on myths that have persisted since the Depression that sticky prices cause markets not to clear, resulting in an oversupply of goods and a disincentive by firms to expand production and hire labor. This inability by the price system to adjust downward when market conditions change reflects a failure inherent in the market system, thus requiring extra-market intervention by central planners, whose solution involves policies meant to increase consumption. If that happens, the resulting increased demand for

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goods and services allows markets to clear, notwithstanding price rigidities.

Or so goes the justification. The many problems with this scenario include the fact that prices actually do adjust downward—rigidities are rare in competitive markets and more common in regulated ones. So if markets are not clearing in the midst of a correction, the problem is outside the market. The culprit is interventionism, not the price system.

Say you run an automobile factory and no one is buying your cars at the average price of $20,000 each. Your dealers' lots are growing and your supply chains are getting clogged—both indicators of a downward pressure on prices. You can either (a) cut back production and lower your average price, or (b) wait for consumer demand to increase. The planners now formulating stimulus packages assume that you and millions of other economic actors facing similar choices will opt for the second strategy. Since markets would fail us when this happens, they require some manipulation of consumer demand for them to work.

An objection to such policies—besides the obvious ones dealing with their similarity to those of Italy, circa 1933—is that they set the stage for a more significant correction in the future. Policies that force consumers to spend are also policies that force them not to save, and saving is essential for long-term, sustainable economic growth. When people don't save today, they consume less in the future, again causing inventories to rise and supply chains to become clogged. At best, forced spending can only postpone market corrections, and the more it depletes saving, the more severe the eventual correction.

It doesn't help that such demand-side policies themselves became sticky, entrenched as Keynesian policy institutions. While much of economics as a science has moved on from Keynesian theory—meaning that it has moved closer to the Austrian position, which was contra Keynes from the beginning—old policy levers maintain political value. They often show up in the form of calls for economic stimuli.

The problem for free-market economists is that their policy recommendations at the dawn of recession are not too sexy to the political mindset. They involve either doing nothing to hinder price adjustments, or actively removing extra-market barriers to price adjustments that already exist. This often involves short-term pain in exchange for long-term solutions, when politics rewards short-term solutions that result in long-term pain.

History proves this point. Prior to the creation of such barriers, economic corrections were much shorter affairs. Recessions were called panics and they rarely lasted more than three months. Massive, sustainable wealth was created—indeed, the Industrial Revolution occurred under these conditions. It was only when those who would obstruct necessary price and wage adjustments during a correction became a permanent part of government bureaucracy that real growth rates tapered and business cycles began to measure longer and more painful corrections, each requiring a new round of so-called stimulus.

That is what we are experiencing today. It is the folly of governments to spend, inflate, tax, and redistribute. ■

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Stimulus: The Monetary Side

Llewellyn H. Rockwell, Jr.

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Among businesspeople, bankers, and investors, there is a growing fear that the economy is headed toward recession or already in one. But that alone is not the source of worry. After all, an economy if left alone to function in freedom can recover. The real problem has to do with the political response. There is every indication that no matter who comes to be in charge in November, we face a future of massive spending, inflating, and regulating.

And here is the real danger. One only needs to look at such preposterous measures as the "stimulus package" that Congress passed to much fanfare. Dumping money into consumers' hands, drawn from wherever they can get it, is the only means these guys can dream up to shore up prosperity. That only proves that they don't know what brings about prosperity in the first place, which is not Congress but free enterprise.

Economist Robert Higgs compares a "stimulus package" to getting water out of the deep end of the swimming pool and dumping in the shallow end—all with the expectation that the water level will rise. As he emphasizes, economists should never tire of asking where the money for stimulus is going to come from. Mankind has yet to invent a machine to create it out of nothing: it's either taxing, inflating, or going into debt that has to be paid later (and crowds out capital creation now). There is no other way.

Then we face the frightening prospect of a Bernanke-driven inflation. His entire public career has one theme only: the merits of credit expansion without limit. Alan Greenspan at least had some intellectual conviction, way back in his personal history, that there is a downside to printing money without limit. Bernanke seems to think that the printing press he now runs is the Holy Grail of economic recovery.

He never speaks without insinuating that more credit expansion is on the way. He somehow believes that offering this will spread relief and even glee, as if he alone has his hands on the machine that will solve all the world's problems, and he alone knows how to work it. I tell you, it's creepy. What's more, he seems to be the only one who truly believes it.

And consider the way Washington has handled the subprime mortgage crisis and what that portends for our future. Throughout the 1990s, especially after a now-discredited Federal Reserve Bank of Boston propaganda study, banks were hounded by federal regulators to end "discrimination" against people with either poor or no credit ratings. In practice this meant that banks were threatened into giving loans to people regardless of their ability to pay them back. The lending standards that have been an essential part of banking practice from time immemorial were repealed.

Now the same banks are under fire for having granted mortgages to those who can least afford them, even as Washington again considers legislation that would mandate that banks take on less risk in the future. So we have here a politically created problem that is followed by a politically generated nonsolution to the problem. It's as if Washington

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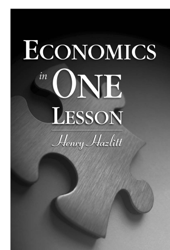
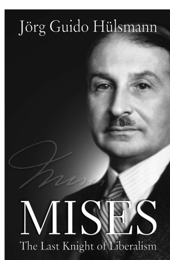


We are very excited about many publishing projects that are in the works, among them a new edition of Henry Hazlitt's *Economics in One Lesson*. This will be the original edition—of one of the greatest timeless classics in the history of economics. It is probably the best introduction to economic thinking. Once you read it, you will find yourself thinking through the points he makes nearly every day. This new edition will be hardbound and be very affordable for students, thanks to donors who have made this possible. Look for it in the spring.



Mises: The Last Knight of Liberalism, by Jörg Guido Hülsmann, continues to be greeted with great celebration from readers everywhere. Professor Jesùs Huerta de Soto said: "This masterpiece on the life of Mises is a great achievement! Its contents and scope surpasses all others already published on Hayek, Friedman, and Keynes." And Bettina Bien-Greaves wrote that this is a "true masterpiece." Readers have found it completely dazzling in every way. Pick up your copy today and enjoy getting to know an unsung hero of the twentieth century.

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will consider any trick to patch up problems of its own making other than simply letting the market work.

In a very strange way, we find ourselves in a position similar to that of 1932, when the United States was in a depression, people were crying out for answers, and free-market logic was ignored or denounced. To be sure, today there is a vast class of pundits, teachers, and other intellectuals who understand, and are constantly aghast at the old-style Keynesianism that is driving public debate. But bridging the gap between private opinion and official policy will require nothing short of a miracle. One need look no further than the presidential election, which could easily be confused for a dictator election.

It is indisputable that, given the state of things, bad economic times will be a forerunner to bad and worse economic policy. The Democrats will give us more spending, regulating, war, and inflation. And this is despite all promises they will give us before the election. Recall that FDR himself ran on a platform of balancing the budget and letting private enterprise cure economic crisis, as John T. Flynn's *Roosevelt Myth* shows.

And the Republicans, absent Ron Paul, will give us, well, the same thing. All these people need to look around at what private markets are doing today. Instead of destroying other people's wealth, they are cooperating with all nations of the world, serving the consumer, and finding innovative and better ways to feed, clothe, house, heal, and entertain us. And what has Washington done? Rob us, badger us, and take us to war.

To be sure, Washington does have obligations. Cutting spending and taxes is a great start. Abolishing agencies that inhibit recovery is essential, starting with the egregious Transportation Security Administration that has done so much to destroy airline travel in this country over the last seven years. It is a Bush-created agency, and one of the great policy errors of the last, well, seven years.

It's true that confidence in the economy is waning. But the response by Washington so far has done nothing to inspire optimism. The more they do, they greater the fears grow. There is a Victorian story about a creature who wonders why everyone is running from him, until he sees a reflection of his own frightful face. It is time for the whole of Washington to look in the mirror. ■

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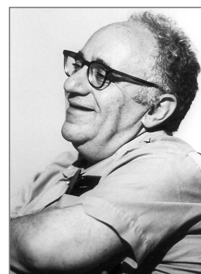

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