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Hyperbole vs. economic reality

Llewellyn H. Rockwell Jr.

Those who follow economic headlines seek the answer to a thousand little questions but only one big one: Are we getting richer or poorer? The flurry of daily data from private and government sources can paint an ambiguous picture. Data can be contradictory. Bursts in consumer spending seem good, but they can also be accompanied by rising debt.

More seriously, the appearance of prosperity can mask underlying decay. At the same time, seemingly bad news, like rising bankruptcies, can actually indicate a much-needed liquidation is taking place, which sets the economy on the growth path for the future. All data need interpretation, which requires good theory, but few media sources are prepared to do the hard work of learning the theory.

An additional problem is the bullish bias of nearly all economic coverage. The media know viewership and readership are higher when the stock market is doing well and the economy is on the upswing. When the economy goes sour, the tendency is for people to avert their eyes, which means fewer readers and viewers. That's why we've been hearing for some 18 months about an impending recovery, which never seems to arrive.

The latest round of bad news, however, is going to be very hard to ignore. The answer to the big question is becoming increasingly obvious: We are losing ground.

The year 2002 was the worst year for equities since 1974. For the year, the Wilshire 5000, which is the broadest measure available, was down 21 percent. That means the market has erased \$2.7 trillion (not a typo) in value since its peak in March 2000. Similar declines hit in the early '70s, but that was before the stock market became the favorite vehicle for middle-class savings.

The profits of retailers in the holiday season also declined. Holiday shopping fell 11 percent between Thanksgiving and Christmas, making this the worst season in 30 years. Retailers are now deeply discounting just to reduce their inventory costs.

Data from the Institute for Supply Management show a manufacturing sector that continues to contract. The ratio between net national product and gross national product is dropping rapidly, which indicates falling production combined with growth in capital consumption. As British economist Sean Corrigan would say, we are eating what we haven't cooked. There

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are signs of strain, with durable goods orders falling.

Federal government spending is continuing to roar ahead, despite declining revenues. The Bush administration is asking Congress to increase the debt limit to accommodate this, for a total of \$6.4 trillion, even as administration officials predict they will have to ask for another limit increase by next year. Meanwhile, the drunken-sailor approach to fiscal policy has done nothing to revive the economy.

The fiscal crisis is afflicting states, which are suffering the deepest deficits in 50 years. States have no central banks to underwrite debt and inflate the currency, so that means one of two paths: spending cuts or tax increases. The former will cause unending screams from the usual interest groups, and perhaps even social unrest, while the latter will be resisted by the middle class, leading to the usual media demonization of middle-class greed.

But is it really greed? Household net worth declined by 4.5 percent percent in the third quarter, to the lowest level since 1995. The ratio of net worth to disposable personal income sank to a seven-year low. This accounts for the sudden slowdown in spending that followed an irresponsible runup of consumer debt. That leaves households worse off than in many years. It's no wonder there is resistance to tax increases.

Meanwhile, recent surveys show that more than half the paid workers between the ages for 25 and 64 have no retirement savings of any kind. Fewer and fewer are participating in optional retirement plans, probably after having been stung in the bear market. No one believes Social Security can make up the shortfall.

The dollar is under stress, oil prices are rising, steel and timber prices have been pushed higher by tariffs, war looms, the unemployment rate has ticked above the crucial mark of 6 percent, businesses are shelving expansion plans, and inflation is threatening (see the oil and gold prices, not to mention the commodities index, which at its highest level in five years).

The problems are not limited to the U.S. but also afflict Europe (still in recessionary environment), Japan (where the stock market just hit a 20-year low), and Latin America (where Argentina just defaulted).

What makes all of these trends notable is that they are contrary to virtually every prediction of every expert for the last 18 months. Just as the onset of the bust surprised most observers, the length of the bust has defied every prediction. Columnists were urging the government to declare that the recession had ended more than a year ago, and yet today, Alan Greenspan is still talking about sluggishness and the great "soft patch."

What about the future? If the roots of the bust are in the excesses of the preceding boom, as Austrian business-cycle theory would suggest, the downside may offer some encouraging news. Belt-tightening and factory slowdowns, even higher unemployment, are exactly what is needed to establish a sound basis for a future recovery.

But this presumes a neutral policy environment — which is to say, the economy can recover if the government doesn't prevent it from doing so. But inflating the money supply, erecting



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protectionist barriers, increasing spending and debt, intervening in labor markets — these are all means the government uses to fight recession that end up making everything much worse off.

Given the behavior of the Bush administration, is it possible we are looking at a long-term decline, that recovery will not be felt for years or even another decade or more? It is possible. The Fed has no tool but to inflate. The government generally knows only how to regulate and spend. Even with the sad example of Japan before us, the government seems incapable of learning how not to handle a recession.

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