

Why Prosperity Will Return in a Year, Think Private Not Public Sector Causes

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Policy makers and media talking heads, up and down the political spectrum, seem to have a unified message: “It will be a long time before the world experiences anything but anemic growth” because “post-bubble recessions are lethal for growth,” according to a widely quoted Wall Street analyst. Moreover, “the U.S economy is running on only one cylinder: government,” the headline writers at the *Los Angeles Times* concluded in a front-page “news analysis.”

The country’s and world’s future economic prosperity depends on what government does in the short term to bail out and stimulate virtually all sectors of the economy and in the long run to reregulate the financial sector (and perhaps all other sectors of the economy). Unless the government acts with decisiveness and force, the credit system will remain “frozen.” The production of goods and services will continue to cascade into a Second Great Depression with economic hardship for practically everyone. Government will be the savior; the public will be among the saved – but only if the government does what it should, piles up trillions of dollars in budget deficits without end and adds tens of trillions in guarantees to private sector financial contracts.

The implied counter message is that private individuals and firms, acting in concert or alone, will have little or nothing to do with any future rebound; they are powerless and at the mercy of what government does or fails to do.

There are three good reasons to retain a healthy skepticism about what has become the conventional assessment of current economic conditions and future prosperity.

- First, policy makers have strong incentive to exaggerate our current economic troubles. Through exaggeration of woes, they increase the chances that their desired policy course will be accepted by Congress and the public, which means they (policy proponents) can then expand their proposed bailout and stimulus packages without the kind of careful scrutiny that can come under less “urgent” conditions. And their strategy has worked in grand style.
- Second, the bailouts and stimulus packages are not likely to have the touted positive effects on the economy.
 - If the government injects trillions of dollars into the economy through targeted banks and other firms (GM and Chrysler, for example), it will have to pull out dollars from the economy through borrowing. If government expenditures can stimulate economic activity, then government withdrawals of dollars can repress economic activity, at least partially offsetting the positive effects of government expenditures.
 - If the government piles up deficits, consumers can be expected to cut back on spending (as they have) for fear of future tax-rate increases. If government spends money to bailout firms that engaged in bad decision making and risk taking, the bailouts can stimulate more of the same – more bad decision making and risk taking long into the distant future, which can be a continuing drag on the country’s potential economic vitality.
- Third, many tens of millions of people in this country and hundreds of millions of people around the globe are now working diligently to find solutions to the economic binds they are now in, or soon expect to be in. Their collective corrective efforts are likely to be more

effective than what Washington does. This is because people have detailed information on their problems and solutions that Washington policy makers cannot know.

- Banks that engaged in conservative lending practices are now in positions to buy up the venturesome, risk-seeking, mismanaged banks (in much the same way that Wells Fargo bought out Wachovia).
- A host of other banks are lending more conservatively, trying desperately to rebuild their trustworthiness. Many will succeed, and as they do, credit will flow more freely again, but with far more focus on the credit-worthy borrowers.
- The current economic debacle has heightened credit standards that have induced people and firms to look for ways to build (or rebuild) their credit worthiness and trustworthiness, as the recent crisis has taught a critically important lesson: Credit worthiness and trustworthiness are essential to prosperity of the individuals, firms, and countries.
- Consumers have curbed their expenditures as they have tried to pay down their credit card and other debt balances.
- Through foreclosures, the country's stock of houses is now gradually being transferred from people who could not afford them to people who can now afford them partly because the prices of houses have collapsed to levels that the credit worthy can be enticed back into the housing market.
- With slack consumer demands, deals in a broad swath of goods and services abound, which will surely stimulate consumer spending more effectively than government bailout and stimulus packages.
- Established storefronts (Linens-N-Things and Circuit City) are now being shuttered, but many stores that have closed would not have lasted long even in good times because of bad

management, not the state of the economy. The important point to remember is that the storefronts are still there, and the closed firms' competitors can now expand with relative ease. Their rental rates will fall until new entrepreneurs with good ideas will find uses for them. And good ideas will continue to flow as people seek ways to rebound from their current bad circumstances.

- With plants closing and employment demand sagging, workers everywhere fear the loss of their jobs. Many are no doubt working harder and smarter to retain the jobs they have, or to create new ones through the development of new products and services that Washington policy makers can't now imagined.
- More and more firms and worker groups will realize that a smart way to save their jobs and to enable their firms to become more competitive and expand sales (as opposed to shuttering plants) will be to accept pay and fringe benefit cuts. The country will continue to adjust prices until prices are realigned and can once again be good guides as to where idle resources can be redeployed.
- The money stock has risen dramatically during the past year, as the Federal Reserve has sought to counter the financial meltdown. From December 2007 to December 2008, the Federal Reserve expanded the monetary base by almost 100 percent; M1 by 18 percent; and M2 by 9 percent. Economists have long known that monetary expansion has a delayed and highly variable effect (with the effect not being realized for nine months or even two years after the Fed eases monetary policy). Some of the impact of the recent past expansion in the money stock will be felt over the next year. This time next year, our greatest concern could well be a return of double-digit inflation, which can have the effect of absolving debtors of the real value of their excessive debts, a force that can lead to an

expansion of consumer and investment demand but that can also give rise to (double-digit) interest rates that compensate lenders for the deteriorating value of their loaned funds.

The message of this commentary is that prosperity is not a thing of the past. The laments of the doomsayers can and should be discounted because they've shown that they have no conception of how people – real people in the economic trenches, not policy makers cloistered in their D.C. offices – are devising their own recovery plans. There is no need for fear of a decade-long malaise or depression – unless the government becomes truly uncorked and thinks it can spend without end its way out of our current troubles and fails to rely on private sector adjustments to our current economic troubles.

The ultimate problem with governmental solutions to economic crises is that they depend on the limited intelligence of a relatively small band of policy makers in the nation's capital for their construction. Those policy makers know little of the problems at the local level of the firm and individual, where the real economic problems reside. The private economy will be the ultimate wellspring of a multitude of small solutions that are devised from the intelligence of the tens and hundreds of millions of people who actually have information on the nature of their local problems that can never be accessed by any band of outspoken policy makers no matter how smart they are, or think they are.

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