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Beware of economic hubris

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President Bush's economic team can rightfully be proud of their policies that produced the sizzling 8.2 percent real economic growth in the last quarter. But before they get too high on their own accomplishments, they need to look at the history of those who began to feel infallible in their economic policymaking.

The Nixon economic team produced strong growth numbers going into the 1972 election, but failed to appreciate the disaster of the surge in inflation stemming from the foolish, excessive expansion of the money supply. Subsequent attempts to control the inflation through wage and price controls only made matters worse. The first President Bush unwisely accepted the advice of his Office of Management and Budget director to increase taxes in 1990, which turned out to be both an economic and political disaster.

President Clinton's economic team thought they could do no wrong, and they were widely acclaimed for the budget surpluses (under the Republican Congress) that occurred in the 1998-2001 period. In retrospect, the budget surpluses, along with mistakes by the Fed and other government regulators, led to the 2001 recession. Clinton Treasury Secretary Robert Rubin and many others failed to realize the budget surpluses were created primarily by huge increases in the effective taxation of capital (i.e., savings and productive investment). Because of the strong economic growth and the stock market bubble, corporate earnings and capital gains realizations soared.

The tax code has been increasingly slanted -- as it was under the Clinton tax increase of 1993 -- to tax upper-income individuals, who provide the bulk of the savings and thus receive a large portion of their income through dividends and capital gains. During this period, much of this increase in earnings from capital was funneled off in taxes to reduce government debt -- which is a low value use -- rather than being invested in higher value private uses. It is also true that considerable capital was wasted during the bubble by overinvestment in certain high-tech sectors, both because of poor business judgments and mistakes by the Federal Communications Commission and others.

But the fact remains, if President Clinton had put in place a Bush-like tax rate reduction no later than the last half of 2000, the recession would probably have been avoided because private impediments to working, saving and investing would have been reduced.

As noted above, economic hubris is a bipartisan sin. Officials of the current administration have imposed trade restrictions on steel, lumber and most recently some textiles despite warnings from even their own and outside economists that these restrictions are destructive. (Fortunately, the administration is backing off the steel tariffs because of expected European retaliation.) The administration has failed to keep government spending -- even nondefense -- under reasonable control, and continues to flirt with damaging regulations, although it knows major increases in government spending and regulations drain the vitality out of the economy. These actions have discouraged necessary foreign investment, as the U.S. looks less hospitable and more reckless.

One administration official, referring to the proposed interest reporting regulation, recently wrote, "nor will it have any noticeable effect on capital investment in the United States," even though there has been considerable expert testimony to the opposite, and no evidence has been provided to support the above assertion. The result of these actions has been a fall in the value of the dollar against the euro and some other currencies and a steep rise in the prices of internationally trading commodities. These commodity price increases are likely to show up in higher prices to consumers that may cause the Fed to curtail money growth and increase interest rates to stop any increase in inflation, which could choke off the economic expansion.

The administration is giving in to special business and labor interests, plus those who slurp at the trough of government spending programs, and even to French tax collectors (because of the proposed regulation to make American banks bear the costs of helping the French socialist state collect taxes on capital from French citizens who invest in the U.S.), rather than the overall interests of the American people. These foolish and dangerous actions are unlikely to do major damage before the election but, unless they are quickly reversed now, a second Bush administration might well find itself in great economic difficulty -- much like the second Nixon administration.

Bush administration officials have been able to get away with this economic nonsense because much of which is spouted from their Democratic opponents is even worse, and too few in the press understand good economics. However, it is not too late for Bush administration economic officials to show they are responsible economic stewards by discarding the above-mentioned economic claptrap, and instead spend the time extolling the virtues of the tax cuts, for which they are genuine economic policy heroes.

History clearly shows good economics is good politics, and that bad economics turns out to be bad politics.

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