denominated debt. Beyond Enron there is Comdisco, Sterling Chemical, Asia Pulp and Paper, Pacific Gas & Electric, Exodus, Globalstar, Enron, AT&T's Excite@Home, Argentina, Turkey, Pakistan, Indonesia. Every one made serious and unique errors; all countries and companies do. But they had one thing in common: heavy debt. Taking 40 percent of incremental income from investors through tax hikes and mangling monetary policy until entrepreneurial debtors have to repay 40 percent more than they borrowed is a sure route to ruin.

When all are afflicted, the scientific method points not to a which-and-whereas hunt for particular infractions, but to isolation of a common source. And that common source was and is a dangerously deflationary U.S. monetary policy, at a time when both vast new telecommunications ventures and the most promising Third World countries were piling on debt. While the dollar has surged since 1996 against the deflated yen, the euro, commodities and gold, the Fed adhered to its view that dollars were too numerous; it sucked them out of the most fertile and vulnerable frontiers of the entrepreneurial economy. The dollar dutifully rose and strangled Third World hopefuls, telecom infrastructure projects, car and computer leasing companies, farmers, steel producers, energy prospectors—anyone who relies on debt finance and a stable standard of value.

Rather than addressing the fundamental problem of deflation, the Bush administration enacted broad protection for the steel industry, thus spreading the damage to all companies that use steel and all companies dependent on trade. Rather than lowering tax rates on investments afflicted with deflation, policy makers obsessed about such rear-view figments as "consumer confidence," a meaningless demand-side statistic.

Even if the U.S. economy ekes forward over the next two years, the world has reached the end of the road for demand-side economics. Supply-side remedies—a stable currency, low tax rates and deregulation of technology—provide the only route to global economic growth and stability. They offer the only way to raise the tax revenues that will be needed to fund a war against terror and support the coming waves of retiring workers.

Money is essentially a standard of value, a code for transmitting information about the supply and demand for goods and services. For a decade, Alan Greenspan's Fed seemed to adhere to a fixed standard of value, guided by a price rule based critically on gold and commodities. But since 1996, the Fed has gone astray, citing as guides to policy the "irrational exuberance of the stock markets," the productivity explosion, the bubble on the Internet, the babble of economic data. Without a proper price rule, markets lack any objective means to differentiate the "news"—a change in monetary conditions—from the white noise of a thousand clamorous markets. When the standard of value itself becomes a commodity, traded like any other on currency markets, the most vital investment information is lost amid the froth.

In essence, Greenspan is now blaming business for his own errors. He created the context for the "crime wave." To save his historic reputation, he should now return to a price rule, sensitive to the telltale worth of the 130 thousand metric tons of gold still available from all time.

Meanwhile, politicians must stop endless tinkering with the structure of law and regulation under which entrepreneurial plans play out. Battered by the vicissitudes of policy, businesses and nations find themselves operating amid a turbulence, in which laws and values themselves are gyrating under the pressure of constant legal and monetary change. *In extremis*, many of them make decisions that in retrospect can be interpreted as incriminating. Bankruptcy is not a crime but a punishment. Virtually no one plans for its concussive effects or expects them. Yet failure is the crucial corrective filter and learning process of capitalism. Only socialist regimes treat blunders as "economic crimes." The real crime wave is tremorous policy and the babel of alibis from politicians and bureaucrats searching for scapegoats.

START ME UP

ANOTHER BOOM AROUND THE CORNER

BY BRIAN S. WESBURY

Many mainstream economists seem to agree with Osama bin Laden, who in one of his videos last November, said that the 9/11 terrorist attacks "struck deep at the heart of America's economy." Nonsense. Even the National Bureau of Economic Research has finally discovered that the recession began last March. It was high taxes, misguided and excessive tightening of monetary policy, combined with lousy regulation in the energy and telecommunication sectors, that created the recession. The actual economic impact of Osama and his nutcase minions was ephemeral. By December—at latest—the economy had already recovered.

All is not back to normal. The rebound still only brought the economy back to a declining trend line. Given the normal lags in the response of the economy to monetary policy, real recovery should not be underway until the sec-

Three cheers for American Spectator economics columnist Brian Wesbury, who topped The Wall Street Journal*'s 2001 list of economic forecasters. His day job is chief economist at Griffin Kubik Stevens & Thompson, a Chicago-based investment bank specializing in fixed-income securities.*

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ond quarter. Corporate profits have fallen so sharply and manufacturers have so much excess capacity that investment in both inventory and equipment will be slow to recover, holding back the rebound.

But the potential growth rate of the U.S. economy is still as strong today as at any time since the Industrial Revolution—maybe even stronger. Knowledge is the secret strength of the U.S. economy. Moore's law continues to drive chip technology to astounding heights. Advances are being made in energy, pharmaceuticals, genetics, telecommunications and manufacturing at a faster rate than ever before in history. Advances in technology continue to boost productivity at a rate well above any mainstream estimates—3 percent annually or even higher. This is the key to the resilience of the U.S. economy.

Venture capital investment, which peaked in the first quarter of 2000 and fell by 72 percent through the third quarter of 2001, is about to turn a corner and head north. That's a key leading indicator. Deflation was a key contributor to strangling the venture sector, but high taxes and burdensome regulation also contributed. The attacks on Microsoft and uncertainties that introduced into the whole vital software sector did not help either.

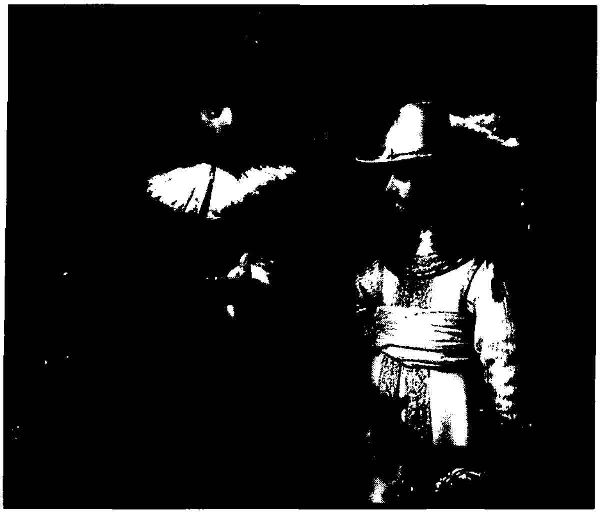
The good news is that deflation is coming to an end. Commodity price indices have stopped dropping, and rose roughly 5 percent in the fourth quarter. Fortunately, this does not mean that inflation is about to accelerate. Productivity, and in the long run, growth in economic efficiency will keep that old bugaboo in check.

Another key factor that will continue to boost economic efficiency is an accelerating pace of globalization. Rather than isolating the U.S., the September attacks on New York and Washington galvanized the world. Russia and the U.S. are active allies—simply amazing. And that helped the Russian stock market jump a remarkable 95 percent in the final quarter of 2001.

Just four months ago, the U.S. was fighting a rearguard action against environmental extremists and overreaching by multilateral organizations of all sorts. Now the Kyoto protocol is in tatters, and the U.S. has taken the point in an assault on repression. Moving toward free markets benefits all citizens of the world and now that the U.S. is in a position of leadership, democracy and capitalism will spread.

Even a supercharged U.S. economy cannot withstand gross policy mistakes. The Federal Reserve, after driving interest rates too high in 2000 and sending destructive deflationary tides through the world economy, has now cut interest rates enough to end the pain. The Bush tax cuts of early 2001, while much smaller than needed, will also help boost business activity. As policy mistakes are corrected, growth will—surprise!—return.

These developments bode well. Initially, the recovery will not be as strong or swift as many predict. But despite appearances, this recovery should be another long and powerful boom. Free trade, stable money, globalization and advances in technology will once again boost wealth and standards of living. These benefits of freedom are something the Bin Ladens of the world will never understand.



FOLLOW THE MONEY

FORGET GDP—WATCH THOSE MOVING ASSETS

BY JOHN RUTLEDGE

Twenty years ago I wrote a piece for *The Wall Street Journal* op-ed page called "Why Interest Rates Must Fall in 1982." At that time Wall Street economists were divided up between those who believed Reagan's tax cuts would lead to big budget deficits, which would drive interest rates up, and those who argued that Reagan's tax cuts would stimulate more savings, and drive interest rates down. I argued they were both wrong: Their deficit and savings rate changes would be rounding errors in the biggest portfolio event of the century.

The volcano the U.S. economy is sitting on is our $86.5 trillion balance sheet—the total value of all the financial and tangible assets in the U.S.

As it turned out, I could not have been more right. Between 1981 and 2001 people in the U.S. shifted more than $10 trillion out of their existing holdings of stuff—tangible assets, like gold, commodities and property—and into financial assets including stocks, bonds and mutual funds. Responding to the collapse of inflation and to tax rate reductions, they drove the prices of paper assets up and hard assets down, creating the biggest bull market in history and forcing a massive restructuring of American industry. If you had gotten that one thing right in 1981, you would be reading this article on the beach. A $100,000 investment then in default-risk-free, thirty-year zero-coupon Treasury bonds, the quintessential financial asset, would be worth more than $2 million today, more than twenty times your initial investment. How many of you can say that about your house?

Don't look around you for economists on the beach: they missed the whole thing. They spent the whole time arguing about budget deficits and trade deficits and revising their quarterly GDP forecasts. Their fixation on macroeconomics—unemployment rates and the GDP accounts—made them miss the greatest show on earth: the $20 trillion repricing and restructuring of the U.S. balance sheet over the past twenty years.

Macroeconomics narrowly beats out Modern Portfolio Theory as the most destructive invention of the 20th century. It gives people the illusion the government can control the economy by manipulating spending and taxes. It provides a rhetorical smokescreen for politically driven tax, spending and regulatory policies. Worst of all, it corrupts our thinking by telling us our standard of living is determined by how much money people are willing to spend.

Macroeconomics textbooks begin with an island metaphor. Some people on the island catch fish, other people pick coconuts. They exchange fish and coconuts with each other, presumably so they get all two major food groups. The island economy's gross domestic product is measured by adding together all the fish and coconuts produced in a year, using an appropriate exchange rate (the market price). GDP serves as a measure of the value of the work people did during the year.

I actually live on the island of Maui, so I know something about island economies. I have fish in front of my house and coconuts in the back, just like in the textbooks. When I go to sleep every night, however, I don't worry about fish and coconuts. I worry about the volcano the island is sitting on. If the volcano erupts during the night, we won't be there to calculate GDP in the morning.

The volcano the U.S. economy is sitting on is our $86.5 trillion balance sheet—the total value of all the financial and tangible assets in the U.S. economy, equal to 8.6 years worth of this year's projected $10 trillion GDP. Even minor disturbances in our huge balance sheet can make waves so large that they swamp the changes in spending, savings rates, budget deficits, and other "flow" measures that macroeconomics talks about. This is especially true for asset prices.

In that *Wall Street Journal* piece twenty years ago, I outlined a simple idea. There are two price theories. The first—supply and demand—is the price theory of Alfred Marshall and George Stigler. It works well for haircuts, guitar lessons, and other perishable goods and services. The second—portfolio theory—is the price theory of Irving Fisher and James Tobin. It works for bonds, Rembrandt paintings, and other storable assets. To get useful answers we must be careful to use the right price theory for a given situation.

By goods and services I mean things with lots of current production relative to existing stockpiles. Perishable products like professional services, airline seat miles and fresh strawberries are good examples. Assets, by contrast, are things with large stockpiles relative to the rate of production. Examples include Rembrandt paintings (he is no longer painting), '57 Chevy's, and beachfront property (they aren't making any more).

Most products, of course, fall somewhere in between: they are somewhat storable and wear out over time. By measuring their stockpile as a multiple of a year's production, though, we can get a

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