reducing the payroll tax. The reason is that all economists have been tied to the procrustean bed of existing national models which exclude all the factors—economic growth, tax shelters, entrepreneurial innovations, transnational and interstate investment flows and demographic migrations—that register the supply-side effects. Meanwhile, the profession upholds the phantasmagorical models of demand-side economics. Because these models find no confirmation in reality—as Jean Baptiste Say proved centuries ago, demand is always and only a side effect of real supply—established economic theories are extremely difficult to learn and remember. You get Nobel prizes for minor and obvious insights in economic geography. Thus the exponents of the standard model are deeply threatened by any reality-based economics.

These experts are now completely in control of Washington, attempting to spend their way to political dominance, while taking well over half the voters off the federal tax rolls and giving actual taxpayers a greater incentive to hide and shuffle existing wealth than to earn or create new wealth. These measures will retard recovery from the recession and reduce revenues. But globalization means that entrepreneurial creativity—in which the United States is increasing its lead—can survive by adopting foreign locales and resources. Countries such as Israel (a global center of innovation) and Ireland (a low-tax haven), China (a manufacturing dervish), and India (ascendant in software) are taking the lead and will help capitalism survive the Lilliputians currently trying to ruin it in the U.S. What will matter, after all, is not whether President Obama approves of markets but whether markets approve of President Obama, who may think he has protected his future by buying off the middle class with tax rebates but will soon discover that his future will be decided by global markets for curriencies and stocks.

George Gilder is chairman of Gilder Publishing, LLC, and a senior fellow at the Discovery Institute.

Robert Higgs

As I write, financial markets are extraordinarily volatile. The Dow Jones index of stock prices often leaps or plunges by hundreds of points in a single day, and broader indexes fluctuate similarly. Such extreme, erratic variations reflect the great uncertainties that economic developments and government actions have created in the minds of traders. The general public is becoming increasingly apprehensive about the economy's future. Unfortunately, the government's actions to date do not portend a bright future for the overall economy, especially in the longer run, which policymakers are disregarding in their haste to bail out failing financial institutions.

Several important policies and economic developments contributed to the creation of the present troubles. For 60 years, the federal government has subsidized the "American dream" of nearly universal homeownership. Starting more than a decade ago, Congress and financial regulators put additional pressure on lenders to accommodate borrowers who did not meet long-established standards to qualify for a mortgage loan. In part because of this pressure, lenders greatly expanded their lending for high-risk subprime and Alt-A mortgages.

Loan originators could do so without losing sleep because in most cases they immediately resold the risky IOUs to others, especially to Fannie Mae and Freddie Mac, the giant government-sponsored enterprises that themselves were responding to the same pressures to widen the stream of mortgage lending. Fannie and Freddie joined forces with financial modeling wizards who devised new ways to slice, dice, and reconstitute the mortgage-backed loans into a bewilderingly complex array of financial derivatives for resale to investors. The wizards also invented credit default swaps as a means of insuring the holders of newly devised securities whose risk was difficult, if not impossible, to establish in actual market dealings.

None of these high-finance hijinks would have been nearly so inviting, however, had the Federal Reserve not undertaken, in response to the recession of 2001, to put in place a regime of exceedingly easy money and credit from 2002 to 2005. The upshot of this policy was a huge increase in the money stock, one measure of which (M2) increased by 35% between January 2001 and January 2006.

Eventually, when the unsustainable investments encouraged by the easy-money policy began to fail, especially in the housing industry, the whole house of cards—erected on the foolish assumption that housing prices would increase forever—began to crumble. Real-estate prices fell, mortgage borrowers defaulted, and lenders found themselves facing actual or potential insolvency all the way up the line. Naturally, these fair-weather capitalists immediately cried out to their friends in the federal government to rescue them. Heedless of what had created the debacle in the first place and fearful of its dire potential consequences, government officials intervened to bail out poorly managed banks and set in motion a partial nationalization of the banking and other industries. The government's commitments for cash infusions, loans, and loan guarantees have already reached the astronomical total of nearly $8 trillion, and more commitments seem likely to follow.

Although the government promises that these measures will be temporary—its loans will be repaid, and the preferred shares it has acquired in banking and other corporations will eventually be sold—we may well doubt this promise. Strong pressures will be brought to prevent a return to the status quo ante. Many of the government's loans will not be repaid, and the government will have to take possession of the collateral—nonperforming mortgages and other obligations of little or no value. Stockholders will resist sales of the government's bank shares because of the negative effect on share prices. With government deeply entrenched in banking and other financial businesses, the president and members of Congress will swarm as bees to honey to turn the government's control in directions they consider favorable to their political prospects. In sum, the bailouts will almost certainly produce another turn of the ratchet toward permanently bigger government.

Robert Higgs is a senior fellow at the Independent Institute and the editor of the Independent Review.

Stephen Moore

Ronald Reagan declared in his first Inaugural Address that "our present troubles parallel and are proportionate to the intervention and intrusion in our lives that result from unnecessary and excessive growth of government." Those words were spoken in the midst of the greatest economic crisis since the Great Depression and are as revelant today as nearly three decades ago.

Three public policy blunders contributed to the current financial market meltdown. First was the disastrous decline in the value of the dollar during George W. Bush's presidency, particularly in his second term. When he was first elected, gold sold for $300 an ounce. By 2007, it had soared to more than $1,000 an ounce. This disastrous collapse in the currency helped contribute to the over-investment in housing that we are now paying a dear price for. The Bush Administration favored a weak dollar policy to help manufacturers. We can see how well manufacturers are doing today. Bush should have followed the Reagan-Volcker paradigm of a strong and stable dollar.

Second, the housing bubble was in no small part a function of federal policies such as the Community Reinvestment Act (CRA) and the explosive growth of Fannie Mae and Freddie Mac, which rewarded mortgage banks for bad and excessively risky lending policies. CRA created a culture of loose underwriting standards that contaminated much of the mortgage lending process. It is doubtful that the bubble could have been so overinflated had Fannie and Freddie not stood by waiting to insure every undercapitalized loan that came their way.

More generally, the governmental expansion under Republicans in the last eight years has diverted capital from high-return to low-return expenditures. When President Bush entered the White House, the federal budget stood at $1.9 trillion. By 2008, it stood at $3.1 trillion and that was before the multi-billion dollar bailout packages. Those bailouts did not create the financial meltdown, but it is a good bet that they have contributed to the depths of our current problems and the stock market sell-off. We have robbed healthy companies of funds to pour money down the rat hole of failing industries like General Motors. For the cost of all federal bailouts we could have suspended the corporate income tax for a year, which would have been a powerful stimulant to growth.

Finally, the election of Barack Obama and the fear of his across-the-board tax rate hikes on capital gains, dividends, and small businesses have created the most bearish policy environment on Wall Street since the late 1970s. Investors are forward looking and they are seeing a tsunami of anti-growth policies. The proper response is to sell while you still can—and that is what investors have been doing en masse.

The solution is a flat tax that dramatically rewards investment and risk-taking and savings, and a broad reduction in government spending to free up resources for productive private spending. The Democrats are fixated on doing exactly the opposite. Good luck to them.

Stephen Moore is senior economics writer for the Wall Street Journal *editorial page and co-author with Arthur B. Laffer and Peter J. Tanous of* The End of Prosperity: How Higher Taxes Will Doom the Economy, If We Let It Happen *(Threshold Editions).*

Alan Reynolds

This recession is not just a U.S. problem, not just about housing, and not just financial. Consider each point, in turn:

Germany, France, Italy, Japan, Singapore, and Hong Kong fell into recession in the second quarter (arguably *before* the United States and United Kingdom) when the price of oil rose as high as $145 a barrel. This was no coincidence. Soaring oil prices raise the cost of production and distribution for many industries, and reduce *real* household incomes and therefore consumption.

In 1983, economist James Hamilton of U.C. San Diego showed that "all but one of the U.S. recessions since World War Two have been preceded...by a dramatic increase in the price of crude petroleum." By the year 2000 we had been through *nine* dramatic spikes in the price of oil, every one of which was soon followed by recession. Writing in the *Financial Times* on January 2, 2008, I suggested that "the U.S. economy is likely to slip into recession because of higher energy costs alone, regardless of what the Fed does" (and regardless of housing too).

Ten months later (November 8), the *Economist* noted that, "All three previous recessions came after housing booms and oil shocks." They were talking about the U.K., but could have been talking about the U.S. Yet housing slumps can be a consequence of recession rather than a major cause. The housing bust in places like Detroit and Cleveland was not preceded by a boom.

Aside from hot spots in California, Nevada, Arizona, and Florida, the American housing boom was less exuberant than many others. On December 6, 2007, the *Economist* revealed that housing prices had increased 102% over the previous decade in the U.S., but 144% in France, 159% in Australia, 190% in Spain, 213% in Britain, and 240% in Ireland.

When the U.S. economy began to contract in 2008, the biggest drop in housing starts was behind us. Falling residential investment subtracted more than a percentage point from real GDP growth in 2006 and 2007, but only half a point in the second and third quarters of 2008. By the second quarter of 2008, home prices were lower than a year earlier in ten states, according to the Office of Federal Housing Enterprise Oversight (OFHEO), but higher in 26 states.

Unbearable increases in the world prices of oil and metals are a better explanation of the recession's geographical and industrial breadth, regardless of the added problems with housing and finance. And that, in turn, means falling prices of oil and metals are sowing the seeds for recovery in 2009—including a housing recovery.

What about finance? The November 10, 2008 issue of *Business Week* said, "Despite the government's best efforts, it may be 2010 before U.S. banks are willing to lend freely again." But bank lending was flat or down only between April and July of 2008. After that, the Fed's weekly H.8 report showed bank loans rising steadily from $6.91 trillion in July to $7.27 trillion by late October. The sudden bankruptcy of Lehman Brothers caused money market funds to shun commercial paper for the few weeks ending October 1, but nonfinancial commercial paper outstanding rose 9% in the following five weeks. Interest rates on interbank loans (Libor) came down too. Even if more credit was a sensible solution to excessive debt, the "credit crisis" has been exaggerated.

By the time of the U.S. presidential election, the multi-causal global recession was half over. Because unemployment is a lagging indicator, unfortunately, we won't hear that the recession has ended in 2009 until at least another few months have passed.

Alan Reynolds is a senior fellow at the Cato Institute and the author of Income and Wealth *(Greenwood Press).*