

# The Conservatives' Big Mistake

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Many conservatives rightly worry about the economic impact of the liberal policy agenda emanating from Washington, D.C. They warn of a dollar collapse, tout gold as the investment of choice, and forecast that the stock market will not go higher. Many agree that things have gotten better in recent months, but boldly predict a double-dip recession, or even Great Depression II.

The problem is that they are confusing the long-term economic impact of big government with the short-term impact. It is true that big government policies of higher taxes, increased spending, national health care, and a carbon tax will hurt the economy, drive up unemployment, and create inflation. But, it is also true that all these things are unlikely to happen “right now.” These are long-term problems.

So far, the health care proposals on the table and Cap and Trade are both back-end-loaded—their true cost will not be felt for at least three years, maybe more. And tax hikes are not going to be a reality until at least 2011, maybe later. In the meantime, the economy is climbing out of a very deep hole—the first true economic panic since 1907—what I call the Panic of 2008. And this panic was caused by policy mistakes made by George Bush and Hank Paulson.

In my forthcoming book, *It's Not As Bad As You Think* (Wiley, 2009), I argue that easy monetary policy alone (combined with a V-shaped bounce off a very low bottom) will lift economic activity strongly throughout 2010. The economy is set to boom, just as it did in 1975–76 in the midst of a decade of terrible government policy. Another example

is the “Clinton Recession” that never happened. Easy money in 1993 kept the economy afloat despite the Clinton tax hikes and the attempt at HillaryCare.

As a result, when conservatives argue that we should all be digging metaphoric foxholes and keeping 'round the clock vigilance against the worst type of economic calamity, they'll begin to look foolish over the next 12 to 18 months. One could argue that conservatives' ability to stir up fear about the impact of these types of policies on the economy is politically effective. After all, it worked with President Clinton, who was forced to change stripes mid-stream. But an economic recovery was already underway when he was elected.

When President Obama was elected, the economy was on the way down. So, as it begins to recover, it is going to look as if government stimulus, cash-for-clunkers, and the calm demeanor of the new photogenic and hopeful president were the cause. We're already hearing some of this. And if that line of thinking catches on in the months ahead, then conservatives who keep saying, “Buy gold and head for the hills,” will be walking into a right upper-cut.

## The V-Shaped Recovery

There are three things lifting economic activity and the stock market right now. First, is a corrective fix to market-to-market (MTM) accounting. *The American Spectator* played a crucial role in this when it ran a series of high-profile op-eds in late 2008, highlighting the damage done by MTM rules. And in March 2009, the House Financial Services Committee decided to hold a hearing with the

Financial Accounting Standards Board and put pressure on it to change the rules. The announcement of that hearing in mid-March coincides perfectly with the bottom of the stock market.

By allowing banks to use “cash flow” to value assets, not just fire-sale bids in the marketplace, the change in rules brought to an end the vicious downward spiral of capital impingement. Since then, government programs like PPIP, which was designed to buy up the toxic assets, have basically withered on the vine. By mid-summer, the Treasury was saying that the budget deficit would be smaller by roughly a quarter billion dollars this year because the anticipated need to prop up banks had evaporated.

Second is that the panic is ending. In the fourth quarter of 2008, economic activity plummeted—what economists call a drop in the velocity of money. Grocery store sales fell for the first time in 50 years, while car sales fell below the scraggy rate. Everyone, except for the true hermits, changed their behavior and pulled back. This could not last. And now, economic activity is bouncing back.

Third, the Federal Reserve is maintaining a super easy monetary policy stance. With new money flooding into the system and interest rates near zero, the Fed is easier than it has been in decades. The economy is floating on a sea of liquidity. This is impossible to fight. The economy can't help but head higher.

In addition to these three developments, what we are finding out is that capitalism is not dead. Despite a widespread belief that our system of private enterprise had become overly complicated, overly risky, fragile, and impaired, the economy is proving its resilience once again.

I can understand liberals not believing in the capitalist system. They think free markets are unstable and government is the solution. What I don't understand is how quickly conservatives gave up on capitalism. One problem is that people, of any stripe, misunderstand entrepreneurship. Taking economic risk does not mean gambling. Entrepreneurial decisions are designed to limit risk and increase the odds of success. And after 200-plus years, and trillions of decisions, the American entrepreneur has created a very robust and resilient economic system. It is nowhere near as fragile as people think.

That's why it is bouncing back so rapidly although many, mostly non-entrepreneurs, seem scared of their own shadows right now. At this writing, single-family housing starts

are up for five months in a row and are now 37 percent higher than they were in February 2009. Just about every piece of economic data, except for consumer confidence, is tracing out a V-shaped recovery. But confidence has never been a leading indicator and it will follow the economy in the months ahead.

Conservatives should be making moral arguments against big government, and pointing out the long-term economic damage of undermining freedom, but for some reason, most of our conservative politicians are afraid of moral arguments. This is why they would rather fret about the short-term economic data.

The free market capitalist system is the best system for supporting human dignity and pushing humans to behave morally. It does this by allowing individuals to take personal responsibility for their behavior. It allows individuals to find their most productive occupation, and forces people to face the challenges of the real world head on. It respects competition between free people. This is why it works and why only capitalism, of all systems, has led to

permanently and significantly higher standards of living.

Today, the government spends roughly 40 to 45 cents of every health care dollar, while it also spends roughly 75 cents of every education dollar. These two sectors have more problems than any other two sectors of our economy. The greater the government interference in the competitive landscape, the higher the prices and the lower the quality. What more proof do we need?

In the end, undermining capitalism and supporting big government will harm the economy and hollow out people. Nonetheless, the economy is set to boom in the next 12 to 18 months and if every argument against bigger government is based on the performance of the economy right now, its advocates will appear to be wrong. If that ends up helping to push more government programs, it will be a very sad development indeed.

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