Scare-Mongering,

Poor forecasts from the false prophets of gloom and doom.

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Ross Perot, one of the strongest political third-party presidential candidates of the twentieth century, during his 1992 campaign predicted a "giant sucking sound" bringing down the U.S. economy and destroying millions of jobs if the Northern American Free Trade Agreement (NAFTA) went into effect. That made Perot a leading economic scaremonger. Like the others, his crystal ball was cloudy.

Since NAFTA went into effect on January 1, 2004, there has been no "giant sucking sound." Here is what really happened, as recorded by the Bureau of Labor Statistics:

- The U.S. economy has created 23.5 million jobs.
- Unemployment has dropped from 6.6 percent to 4.4 percent.
- Real hourly wages for non-supervisory private sector workers rose 11.5 percent.
- Real hourly wages for non-supervisory workers in manufacturing rose 7.7 percent.
- Real employment compensation, in wages and benefits, rose about 20 percent.

Perot is not alone among the prophets of gloom and doom who have collided with a rosier reality. On the economic front, a billionaire investor, former Cabinet members, a senior U.S. Senator, and a *New York Times* columnist have all issued faulty forecasts of doom. Since the September 11 terrorist attacks, gloomy prophets have inaccurately predicted a devastating new attack.

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Why have these savants been so wrong so consistently? Often it is because they desperately desire bad consequences if their policy recommendations are not followed. Perot was so convinced of the desirability of trade protection that he painted economic disaster as the alternative.

The classic example is investor Warren Buffett, the favorite billionaire of the liberals as a foe of President Bush's tax cuts. Buffett for years has been echoing Democratic politicians in bemoaning the "twin deficits" (budget and trade). At the beginning of 2005, the world's second richest person went further. "Unless we have a major change in trade policies [in other words, protectionism], I don't see how the dollar avoids going down," the Oracle of Omaha told CNBC.

Buffett characteristically put his money where his mouth is, betting against the dollar in his investments. The dollar did not collapse, and Buffett's Berkshire Hathaway got a haircut. The investment company, which had returned a 23 percent gain the previous five years, fell 2.4 percent over twelve months.

But the man who has been dubbed "the world's greatest investor" would not admit he was wrong. In the face of his losses, Buffett this year said "over time, the dollar is going to weaken. I have no idea whether it will be this year or five years from now, but I think we are following policies that will cause the dollar to weaken over time." Dollar decline, he added, will build inflation: "The more you owe, the more it becomes attractive to devalue the currency in which your debts are denominated."

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Buffett Boo Boo

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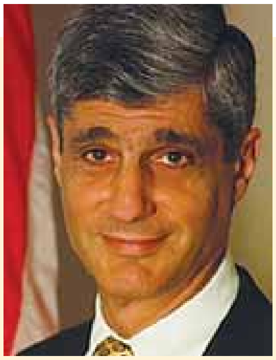
Warren Buffett *who for years has bemoaned America's twin deficits.*



Robert Rubin

Did I Say Up?

Robert Rubin, shortly after George W. Bush's re-election, forecast that a falling dollar would send interest rates up out of control if the federal budget deficit was not reduced—reduced by higher taxes. Taxes were not increased, but somehow the dollar did not collapse, and interest rates actually did not soar.

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banker Peter G. Peterson (often described by the press as "the highly regarded" Peter G. Peterson) was ploughing the same dreary ground in his best-selling book, *Running on Empty.* Warning about the twin deficits and the Baby Boomers reaching retirement age, Peterson predicted a bleak economic future for this country. America "soon will become a bankrupt nation," Peterson wrote.

Actually, the co-founder of the Blackstone Group has been warning of economic doom at hand ever since 1972 when he left government forever after a single year as Secretary of Commerce. Ever since Ronald Reagan's presidency, Peterson has railed against Republican tax cuts, through year after year of economic growth.

Like many of the scaremongers, Peterson is upset with what he claims is the decline of the once-towering American savings rate to zero or near zero. He and similar critics measure savings simplistically as earnings minus spending, overlooking home equity, pensions, and capital appreciation on retirement investments.

Much of Buffett's and Peterson's gloom has been echoed by Robert Rubin since he left government. The investment banker, whom his admirers call the greatest Secretary of the Treasury since Alexander Hamilton, was just as wrong in his prediction shortly after George W. Bush's re-election. He forecast that a falling dollar would send interest rates up out of control if the federal budget deficit was not reduced—reduced by higher taxes. Taxes were not increased, but somehow the dollar did not collapse, and interest rates actually did not soar.

When Bush as president promised to cut the budget deficit in half by the end of his second term, Rubin said, "Nobody thinks you can grow out of [the deficit]." In fact, the projected deficit has been cut by more than that in less than two years, without a tax increase and with increased spending. The deficit anticipated in 2004 at $521 billion has been reduced to $248 billion.

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The theme sounded by Buffett and Peterson has been echoed in Congress—most consistently, Sen. Byron Dorgan of North Dakota. Dorgan, a Democrat, follows the pattern of his populist Republican prede-

Martin Feldstein

Ben Bashing

Martin Feldstein, writing in the *Wall Street Journal* on August 7, 2006, called Bernanke's "optimistic outlook" on inflation "unlikely," adding: "A mild slowing of economic growth is generally not sufficient to reverse rising inflation." Feldstein, once considered by many as more likely than Bernanke to be Greenspan's successor at the Fed, was posing the old Phillips Curve formulation that only hard times could slow inflation. He was wrong.

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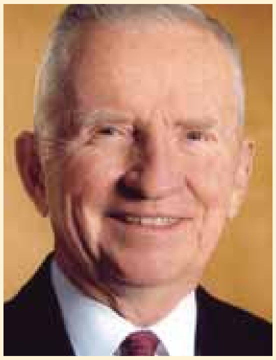

Ross Perot

Ross Who?

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—*R. Novak*

cessors from the Great Plains (called "sons of the wild jackass"). He frequently takes the Senate floor to forecast the end of the American dream.

"American people who used to have good manufacturing jobs have now discovered themselves all too often jobless," Dorgan contended early last year. A year later, he ignored the reduced unemployment rate (in opposing the trade agreement with Oman) to contend that "Forty-two to 56 million American jobs, in manufacturing and especially the service sector, are tradable jobs, subject to outsourcing."

Words of these false prophets are uncritically applauded by journalists, who sometimes join in the scaremongering—notably Paul Krugman, the economist turned *New York Times* columnist. Writing in October 2003, he declared George W. Bush would be the first president "since Herbert Hoover to end a term with fewer jobs available than when he started." Actually, despite breaking the dotcom bubble and the 9/11 attack, the United States did not lose jobs during the first term of Bush's presidency.

Two years later, Krugman was warning of worse to come in the economy. He called it "so ominous to see signs that America's housing market, like the stock market the end of the last decade, is approaching the final, feverish stages of a speculative bubble" because there would be nothing to replace housing. In fact, while the housing boom has ebbed, consumer spending, consumer confidence, and the stock market have hardly collapsed.

Economists and journalists commonly predict recessions that do not happen, but they have been particularly off the mark in predicting a hard landing—that is, a recession—for Ben Bernanke as the new Federal Reserve Chairman. "The economy that Alan Greenspan is about to hand over is in a much less healthy state than is popular assumed," said *The Economist* of January 14, 2006, adding that the change in leadership at the Fed "could well mark a high point for America's economy, with a period of sluggish growth ahead." That demonstrably has not been the case in the nearly eleven months since this prediction was published.

Among Bernanke's mistaken critics was Martin Feldstein, the Harvard economics professor and longtime Republican adviser. Writing in the *Wall Street Journal* on August 7, 2006, he called Bernanke's "optimistic outlook" on inflation "unlikely," adding: "A mild slowing of economic growth is generally not sufficient to reverse rising inflation." Feldstein, once considered by many as more likely than Bernanke to be Greenspan's successor at the Fed, was posing the old Phillips Curve formulation that only hard times could slow inflation. He was wrong.

Feldstein was more spectacularly wrong as chairman of President Ronald Reagan's Council of Economic Advisers when he forecast an extraordinarily low growth rate for 1983 of 1.4 percent. He stuck to it in the face of severe criticism, distorting Reagan

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Administration policy (and earning the label of "1.4 Feldstein"). In fact, the 1983 real growth rate was 4.5 percent, followed by 7.2 percent and 4.1 percent in the next two years.

The next terrorist attack has not been falsely forecast as often as the next economic collapse, but such warnings about what was ahead since September 11, 2001, have abounded.

Democrats in Congress have been warning for five years about doom delivered by slipping a bomb into a ship container. Rep. Edward Markey (D-MA): "We will have a ship with a container in Africa, in Europe, in Asia, and one of those containers will have had a nuclear bomb slipped into it. And then that ship, because there is no scanning for nuclear bombs around the world, that ship then heads for a port in the United States." While scary, that is unlikely.

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During a research conference organized by the ECB in Frankfurt in November 2006, Columbia University Economist **Michael Woodford** *made a strong case for the superiority of the New Keynesian models, in which money has no separate role.*

given moment. ECB watching is like playing a game of Now-You-See-Me-Now-You-Don't.

At the point of writing—mid-December 2006—the pillar-one forecasts suggest that present policy is broadly consistent with price stability. The pillar-two analysis, however, postulates that monetary policy should be tighter. Both pillars cannot be simultaneously right.

So we are approaching crunch-time for the ECB's two-pillar strategy. If the present reliance on monetary analysis were to lead to an excessively tight policy—a non-trivial possibility in view of the risks of a U.S. slowdown, or a collapse in the dollar—then the case for a separate monetary pillar would weaken. In this case, pressure will grow to fold pillar two into pillar one. Obviously, the opposite could happen in the—unlikely—event that the present policy stance proves to be too loose.

I am not sure that academics like Woodford and others could ever persuade the ECB to drop money. In any case, the real problem with the ECB's strategy is not that they take money seriously. I would also agree that a central bank should not dispose of money entirely. The problem is a money-based second pillar, which at best gives rise to confusion, and at worst leads to bad policy judgments in the future. ◆

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Embodied in many of the terrorist prophecies is the desire by the scaremongers to further government growth. The 9/11 attack produced immediate demands for a federal employees to replace private screeners at airports. Two months after the attack, Representative Maxine Waters (D-CA) accused those who would not immediately agree "to federalize those screeners" of "playing with people's lives." Senator Robert Byrd (D-WV) said: "Only by federalizing screeners can the American public be assured that cost-cutting will not occur to the detriment of their safety."

But the Government Accountability Office last year reported that private screeners do a better job of detecting dangerous objects than the 45,000-employee, much-criticized Transportation Security Agency. Naturally, the scaremongers have not demanded a privatization of the screening process in the interests of safety.

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The most terrifying recent false prophecy had nothing to do with economics or terrorism and was issued in October by a Russian astronomer. As reported by *Pravda* on October 10: "According to the Russian astronomer Nikolai Fedorovsky, a giant comet flying at top speed is bound for Earth. Should the comet stay on the collision course, it may hit the planet in late October. The impact will cause devastating tsunamis, earthquakes, and avalanches, says Fedorovsky. He saw the killer comet in a telescope two weeks ago. He managed to calculate the comet's trajectory."

But if you are alive and reading this, it means that October has come and gone without the arrival of the killer comet. Mr. Fedorovsky's desire to warn the world and gain attention for himself, has proven useless. Perhaps the fears spread by Buffett, Peterson, et al., should be similarly ignored. ◆