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P.J.'s Treatise *

P.J. O'Rourke's latest book is subtitled "A Treatise on Economics." It has more to say about the origins of wealth and poverty and how they relate to current world conditions than entire shelves of economic textbooks and learned journals.

For most of human history, thought concerning what we now call economics mainly involved notions of "a just price," the wickedness of lending money at interest, and similarly judgmental views about transactions that individuals might engage in among themselves. These were often based on the religious pronouncements of Jesus, Mohammed, or Aristotle, especially as interpreted by St. Thomas Aquinas.

Even the more helpful findings of "enlightenment" thinkers were often based on little more than what E.C. Harwood called "secular revelation." When John Locke concluded that debasement of the coinage by a sovereign was a usurpation of individual rights, or when the French physiocrats asserted that land was the origin of all wealth, their findings were based largely on *a priori* reasoning.

Although he had many precursors, it was Adam Smith who really set the study of economics on a useful course. Smith was a professor of moral philosophy, but his masterpiece, *An Inquiry into the Nature and Causes of the Wealth of Nations,* was based far more on what he observed than on how he believed things ought to be.

In recent decades, where it has not degenerated into sheer mathematical irrelevance, economic inquiry has all too often returned to secular revelation for answers to genuine and imagined economic problems. Yet it is only by understanding the reasons why some individuals and countries prosper and why others fail that sensible policies can be developed and implemented.

Economic Growth is the Central Issue

In other words, the same question that concerned Adam Smith remains the central issue of economics. What causes some countries to grow and prosper, while others stagnate and decline? This is the question that P.J. O'Rourke addresses in his latest book, *Eat the Rich.* He begins, "I have one fundamental question about economics: Why do some places prosper and thrive while others just suck?"

The author first tries to find answers to this question by going "back to the Econ texts I finessed in college and figure things out." He starts with *Economics,* fifteenth edition, by Paul A. Samuelson and William D. Nordhaus, and finds:

> …Professor Samuelson, who wrote the early editions by himself, turns out to be almost as much of a goof as my friends and I were in the 1960s. "Marx was the most influential and perceptive critic of the market economy ever," he says on page seven. Influential, yes. Marx nearly caused World War III. But perceptive? Samuelson continues: "Marx was wrong about many things...but that does not diminish his stature as an important economist." Well, what would? If Marx was wrong about many things *and* screwed the baby sitter? [Marx did that too — *Ed.*]
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> …*Economics* is full of passages indicating that Samuelson (if not William-come-lately Nordhaus) disagrees with that reactionary idea, the free market. The chapter titled "Applications of Supply and Demand" states "…crop restrictions not only raise the price of corn and other crops but also tend to raise farmers' total revenues and earnings." Increase your corn profits by not growing corn? Here's a wonderful kind of business where everybody can get rich if they'll just do nothing.
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> In the chapter "Supply and Allocation in Competitive Markets," the book seems to be confused about the vary nature of buying and selling. "Is society satisfied with the outcomes where the maximal amount of bread is produced," it asks, "or will modern democracies take loaves from the wealthy and pass them out to the poor?" Are the rich people just going to keep those loaves to grow mold? Why would they produce the "the maximal amount of bread" to do that? Or are we talking about charity here? If so, let us note that Jesus did not perform the miracle of the loaves and taxes. We all know how "modern democracies take loaves from the wealthy." It's the slipups in the "pass them out to the poor" department that inspire a study of Econ.
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> It was not reassuring to learn that the men who run the companies where our 401(k)s are invested have minds filled with junk from the attic of Paul A. Samuelson's *Economics.*
>
> There were newer texts than *Economics* for me to look at, and what they said wasn't so obviously wrong. But then again, what they said wasn't so obvious, period... And the less popular but more worthwhile books all seemed to presume that I'd made it through something like *Economics.*
>
> So I gave up trying to be smart about economics. I decided that if I wanted to know why some places were rich and some other places are poor, I should go to those places.

Accordingly, most of the book (8 out of 11 chapters) is a description of P.J.'s visits to various countries around the world, something that he has done in several previous books. In this instance, his visits are in pairs that bring out similarities in organization and differences in outcomes.

Capitalism, Good and Bad

He begins by contrasting what he calls the "Good Capitalism" of Wall Street, with "Bad Capitalism" in Albania. He found that the people on Wall Street worked very hard and were paid very well, while essentially pursuing their own interests with hardly any thought to the larger implication of their actions.

"What," I asked all the Wall Street people I interviewed, "does the investment industry give to society?" The answer was always the same, "Liquidity," which P.J. concludes "is the Wall Street word for having things you can do with your money." More broadly, the function of Wall Street is the allocation of capital, which it does under quite strict rules; but, as the author

* This article is a review of *Eat the Rich, a Treatise on Economics*, by P.J. O'Rourke, New York, Atlantic Monthly Press, 1998, 246pp., $24 hardbound.

observes, the "restrictions aren't concerned with how much money goes to which place, just with how it gets there."

It is easy to criticize the results of this process, the booms and busts, the cycles of euphoria and despair, but as O'Rourke shows throughout the book, the alternatives are worse, sometimes appallingly so.

Albania, according to the author, "shows what happens to a free market when there is no legal, political, or traditional framework to define freedoms or protect marketplaces." In this situation, "where the shop keepers and the shoplifters have that same status under the law… there's a lot of poverty. …But capitalism conducted in a condition of anarchy produces some less-predictable phenomena. Albania has the distinction of being the only country destroyed by a chain letter."

Various pyramid schemes arose shortly after Albanian communism disintegrated. Their eventual collapse led to widespread rioting and looting. At the time of P.J.'s visit, what little order there was resulted from patrols by 7,000 Italian troops and a 10 PM curfew. P.J. wondered if this had helped stop the looting. His interviewee replied that general pillage had ended only because "they were finished."

However, the author did find that Albanians do live by some rules: "Authority has always rested with the *Mal*, the Albanian word for tribe and also — to give some idea of the cozy interaction among Albanian clans — the Albanian word for the mountain that each village is on top of." He goes on to observe that:

> Culture is an important factor in determining the economic success of a nation. But, that said, what else is there to say? Germany got rich with a culture as barbaric — two World Wars and the Holocaust prove it — as anything ever seen. Tibet stayed poor with a culture so wonderful that half the movie stars in America want to move there."

In this regard, the author tells the story of a Scandinavian economist who asserted to Milton Friedman, "In Scandinavia we have no poverty." Professor Friedman replied, "That's interesting, because in America among Scandinavians, we have no poverty either."

Socialism, Good and Bad

P.J. visited Sweden to find "a socialist paradise." To cite just a few aspects of this: medical care and child care are free, unemployment benefits continue indefinitely at 75 percent of pay, and employees have generous sick leave (which is usually taken on Fridays and Mondays) as well as leave for family care. Government spending totals about 70 percent of GDP.

With 13 percent unemployment, and a variety of other ills, P.J. concludes that Swedish socialism is not working very well — that Sweden's present standard of living reflects past achievements. "From 1870 to 1970, Sweden had a higher rate of economic growth than any other country in the world except Japan, (and Japan was cheating — using the statistical dodge of starting with a nearly Paleolithic baseline)."

The Socialists came to power in 1932, but "they made socialism work by the novel expedient of not introducing any." Very few industries were nationalized and it was only in the 1970s that taxes and regulations (such as the incredibly generous work leave and unemployment compensation mentioned above) began to interfere with the workings of the free market, and Swedish economic growth began to falter.

In Cuba, P.J.'s example of bad socialism, "what could go wrong in theory with an overpowerful government like Sweden's had gone wrong …very wrong." The only efficient part of Cuban society that he found was the police, and the only growth industry seem to be the prostitution of its young women. Enough said.

Two other pairs of countries were visited: Tanzania-Hong Kong, and China (well, Shanghai) and Russia. The first pair makes a predictable contrast between a relatively thinly populated country with many resources that has stagnated under state controls, and a hugely overcrowded city-state built on barren rocks that achieved first-world standards with virtually complete economic freedom.

However, P.J.s take on Russia and China is somewhat unusual. Although most experts seem be believe that China has done better in managing its economy, what P.J. saw in Shanghai was continued vast state-mandated investment — mainly in construction — that he concludes will come a cropper some day soon.

On the other hand, he describes the near anarchy of the Russian economy a little flippantly: "Russia does not yet have an effective system of civil law. The only way to enforce a contract is, as it were, with a contract — and plenty of enforcers. What would be litigiousness in New York is a hail of bullets in Moscow. Instead of society infested with lawyers, they have a society infested with hit men. Which is worse, of course, is a matter of opinion."

Yet, despite the wisecracks and disparagement of the Russians' aping of Western consumption, the author reaches an unusual conclusion — that the Russian economy may be working better than the official bean counters and international functionaries understand. There is far more available to consumers (even in the distant hinterlands) than there used to be, official statistics for imports and exports are up, and apparently, much business is conducted in hard to trace U.S. currency or barter.

Only time will tell if these specific conclusions of the author prove correct, but the overall message of *Eat the Rich* is important and worth repeating: "The modern economy works, and we know how to make it better." We should not lose sight of the fact that the world has been a better and far more rapidly improving place during the past 200 years or so than it was during the millennia of human history that came before. There can be little doubt that it is an increasing understanding of the importance of human freedom to the functioning of markets that made the difference. ❑

BUSINESS-CYCLE CONDITIONS

As the economy enters its ninth year of uninterrupted growth, the leading, coincident, and lagging indicators all suggest that business activity will continue to increase further in the coming months.

According to the latest round of economic statistics, the outlook for continued business expansion remains favorable. Four of the twelve primary leading indicators reached successive new highs for the current cycle and are appraised as clearly expanding. The four new highs are *M2 money supply*, *new orders for consumer goods*, the *ratio of manufacturing and trade sales to inventories*, and the *index of common stock prices*. *M1 money supply,* the narrowest measure of money, increased slightly and remains appraised as clearly expanding. (M1 and all dollar-denominated series are reported in constant dollars.) Thus, a total of five of the twelve leaders are clearly expanding.

Last month, after several months of increase in the base data for the *3-month percent change in sensitive material prices*, the series was upgraded from clearly contracting to probably contracting. This month's increase in the data was deemed sufficient to warrant upgrading the series' appraisal again, this time from probably contracting to cyclically indeterminate. *Vender performance*, the percentage of purchasing managers reporting slower deliveries from their suppliers, also warranted upgrading this month. The

cyclical status of this series is now indeterminate.

Following two consecutive monthly increases in the base data for *contracts and orders for plant and equipment*, the series declined this month. This decrease, however, was not enough to reverse the direction of its moving average. It remains appraised as probably expanding. Both *initial claims for unemployment insurance* (inverted) and the *change in consumer debt* increased this month and remain appraised as probably expanding. This month's figure of 291,000 new jobless claims marks the lowest number of claims filed during the current expansion and the fewest since December 1973.

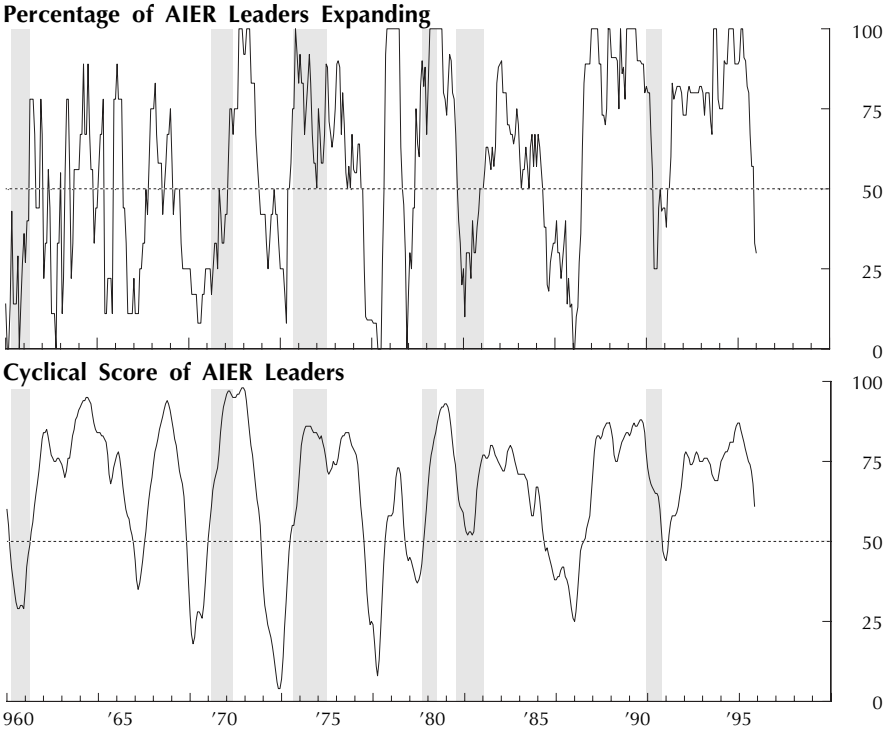
Although the *index of new housing permits* reached a new high last month, its base data is down for the second successive month. As a result of these back-to-back decreases, the 3-month moving average changed direction, thus warranting a downgrade in the series to probably increasing from last month's clearly expanding. The *average workweek in manufacturing* remained at 41.6 hours, but the moving average of that series declined. After several months of being appraised as probably contracting, the cyclical status of the workweek in manufacturing is now appraised as clearly contracting. The average weekly hours of overtime in manufacturing has averaged 4.5 thus far this year, down slightly from the average of 4.8 hours during the same period last year.

Overall, 90 percent (nine out of ten) of the primary leading indicators with apparent cyclical trends are expanding, up from the 75 percent recorded for each of this year's first three months. The cyclical score, AIER's purely mathematical measurement of the twelve leading indicators, decreased one point to 75. Both of these leading diffusion indexes remain well above the threshold of 50, below which recession becomes statistically more probable than continued expansion in business activity.

Four of the six primary roughly coincident indicators, *including nonagricultural employment*, the *index of industrial production*, *manufacturing and trade sales*, and *gross domestic product* (GDP), reached new highs this month. The four series remain appraised as clearly expanding. Nonagricultural employment increased by 46,000 jobs and now stands at 127,678,000. Despite the overall increase in employment, the manufacturing sector lost 35,000 jobs in March. The final estimate for GDP indicates that the economy grew at 6 percent in the final quarter of 1998. The final estimate was lower than last month's preliminary figure of 6.1 percent, but higher than the advance estimate of 5.6 released in January.

According to the latest statistics, for *civilian employment as a percentage of the working-age population*, 64.3 percent of the population is employed. The base data for the ratio has declined for the second straight month, thus reversing the direction of its two-month moving average. However, the series remains appraised as clearly expanding. Both the number of

Percentage of AIER Leaders Expanding



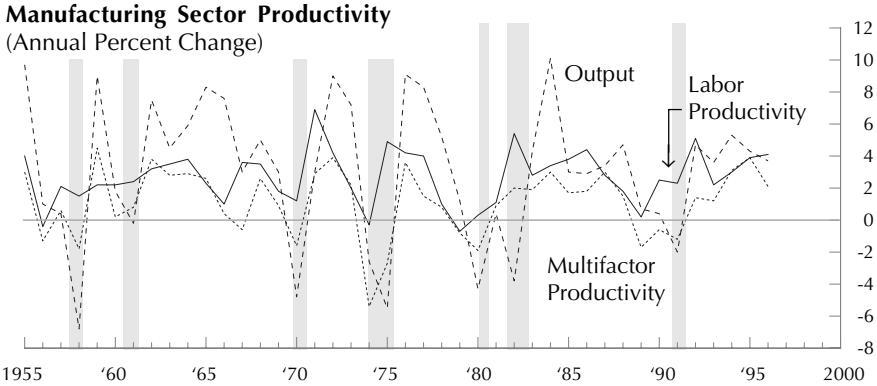
Statistical Indicators of Business-Cycle Changes

Change in Base Data					*Cyclical Status*		
Dec.	*Jan.*	*Feb.*	*Mar.*	***Primary Leading Indicators***	*Feb.*	*Mar.*	*Apr.*
+	-	+		M1 money supply	+	+	+
+	+	+		M2 money supply	+	+	+
+	+	+		Change in sensitive materials prices	-	-?	?
+	+	-		New orders for consumer goods	+	+	+
+	+	-		Contracts and orders for plant and equipment	+?	+?	+?
+	+	-	-	Index of new housing permits	+	+	+?
-[r]	+			Ratio of manufacturing and trade sales to inventories	+	+	+
-	+	-	+	Vendor performance	-?	-?	?
+	+	-	+	Index of common stock prices (constant purchasing power)	+	+	+
nc	-	nc	nc	Average workweek in manufacturing	-?	-?	-
-	+	+		Initial claims for unemployment insurance (inverted)	+?	+?	+?
-	+	+		Change in consumer debt	+?	+?	+?
				Percentage expanding cyclically	75	75	90
				Primary Roughly Coincident Indicators			
+	+	+	+	Nonagricultural employment	+	+	+
+	nc	+	+	Index of industrial production	+	+	+
+	nc[r]	-		Personal income in manufacturing	?	?	?
+	+			Manufacturing and trade sales	+	+	+
+	+	-	-	Civilian employment to population ratio	+	+	+
+				Gross domestic product (quarterly)	+	+	+
				Percentage expanding cyclically	100	100	100
				Primary Lagging Indicators			
+	+	-	+	Average duration of unemployment (inverted)	+	+	+
+[r]	+			Manufacturing and trade inventories	+	+	+
-	+	+		Commercial and industrial loans	+	+	+
+	+	+		Ratio of consumer debt to personal income	?	+?	+?
-	nc[r]	-		Change in labor cost per unit of output, manufacturing	?	?	?
+	-	-	+	Composite of short-term interest rates	-	-	-
				Percentage expanding cyclically	75	80	80

nc No change. [r] Revised.

Under "Change in Base Data," plus and minus signs indicate increases and decreases from the previous month or quarter and blank spaces indicate data not yet available. Under "Cyclical Status," plus and minus signs indicate expansions or contractions of each series as currently appraised; question marks indicate doubtful status when shown with another sign and indeterminate status when standing alone.

Manufacturing Sector Productivity
(Annual Percent Change)



unemployed persons, 5.8 million, and the unemployment rate, 4.2 percent, decreased in March.

Personal income in manufacturing fell slightly this month, but not enough to reveal a cyclical trend. Although all series must eventually be appraised as expanding or contracting, the series' cyclical status remains indeterminate.

Overall, 100 percent (five out of five) of the primary roughly coincident indicators with apparent cyclical trends are expanding, matching the number posted for each of the previous three months of 1999.

Of the six primary lagging indicators, *manufacturing and trade inventories* and *commercial and industrial loans* both reached new highs for the current cycle. Each is appraised as clearly expanding. After reaching a new high last month, the *average duration of unemployment* (inverted) now stands at 13.65 weeks and continues to be appraised as clearly expanding.

After last month's warranted upgrade to probably expanding, the base data for the *ratio of consumer debt to personal income* increased to 17.97 percent. Despite approaching its record high reached in August 1996, the series cyclical status remains appraised as probably expanding. Four successive months of increases has pushed this series near its August 1996 record high of 18.04 percent.

The final two primary lagging indicators, the *percent change from a year earlier in manufacturing labor cost per unit of output* and the *composite of short-term interest rates* did not warrant any changes in their cyclical status. The base data for labor costs fell yet again. However, the series still has no identifiable trend and therefore remains indeterminate. Although the composite of short-term interest rates rose to 4.82 percent, the modest increase of two basis points was not sufficient to change its cyclical status from clearly contracting. In its last meeting on March 31, the Federal Reserve's Federal Open Market Committee (FOMC) voted to leave interest rates unchanged. The FOMC next meets in May.

Overall, 80 percent (four out of five) of the primary lagging indicators with apparent cyclical trends are expanding, unchanged from last month. The strength in the lagging indicators raises some concern, as in previous cycles the lagging indicators expanded just prior to a slowdown in the leading indicators. Nonetheless, four leaders are at new highs and 90 percent with apparent cyclical trends are expanding — and there are few indications of bottlenecks forming in the economy. The business outlook remains favorable.

Productivity Measures

Productivity is a measure of output relative to some input measure. Long-term trends in productivity may reflect a variety of underlying trends, including: technological improvements in production processes, improvements in workers' skill or capital equipment, improvements in efficiency of production, or increases in the share of output in "higher productivity" industries. As Nobel Prize Laureate Robert Solow once quipped, understanding what productivity measurements mean is more a "confession of ignorance than a claim to knowledge."

Nevertheless, the most popular measure of productivity remains that of labor productivity, released quarterly by the Bureau of Labor Statistics (BLS). Increases in labor productivity—the ratio of output to hours worked—lead to increases in consumer buying power and higher average standards of living. Labor productivity in the manufacturing sector[1] has grown slowly but steadily since 1955, averaging 2.76 percent during the period.

But in the long run, overall productivity is overwhelmingly influenced by factors that may have no relation to how "long" or "hard" or "well" a particular generation of workers is laboring. For example, probably few would question that the ditch digger who sweated with a pick and shovel for ten hours at a stretch "worked as hard" as today's backhoe operator. But the backhoe operator in ten minutes can accomplish what it took the ditch digger a full day to do. Despite what workers are trained to do and how well they do it, long-term productivity growth seems most directly linked to cost-saving innovation in non-labor inputs.

In an attempt to separate the influence on output from using more inputs from the effects of innovation and improved technology, the BLS devised a new measure of productivity known as multifactor productivity (MFP). MFP is the ratio of manufacturing output to an index of inputs comprised of labor hours, capital services employed, and intermediate inputs purchased outside the sector, including energy, materials, and business services. The inputs are weighted according to their share of total costs. In manufacturing, intermediates are the largest input in terms of cost. The growth in MFP measures the excess of output growth over the growth in the index of combined inputs. This difference measures the part of output growth that is not attributable to changes in the quantity of inputs. Given that MFP growth is what is left after accounting for the growth in all inputs, it is a better measure of overall efficiency in the manufacturing sector than labor productivity.

The growth rates of manufacturing output, labor productivity, and MFP are shown in the accompanying chart. Both MFP and labor productivity exhibit some cyclical behavior, with each measure falling off at the end of an expansion and leading the economy during recoveries. Neither series, however, has much value as an indicator of future economic activity because labor productivity statistics are released quarterly and the data for MFP are reported only yearly. ❑

[1] Manufacturing is the only sector for which the Government has good data on inputs and output. Productivity measures are less reliable for service industries than for manufacturing since output is harder to measure in the service industry.

PRICE OF GOLD

	1997	*1998*	*—— 1999 ——*	
	Apr. 24	*Apr. 23*	*Apr. 15*	*Apr. 22*
Final fixing in London	$340.90	$312.75	$283.65	$283.40

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