Clive Crook

So Many Greenspans, And All Of Them Human

Alan Greenspan is so busy driving down interest rates, ruling on the nation's budgetary priorities, and generally running the country, that it is difficult at the moment to pay much attention to less important parts of the government, such as the White House and Congress. George W. Bush apparently agrees. He apologized again this week for speaking out of turn when he welcomed the first of the Fed's recent cuts in interest rates. A shocking episode, that: Who does Bush think he is? The effrontery. Presuming to approve of the Fed's actions!

Still, it was just a lapse. The Bush Administration has decided that from now on, it knows its place and will stop this self-aggrandizing behavior. "I learned a pretty good lesson," the President said. "That's the last time I'm going to comment about the actions Mr. Greenspan takes."

Could the Greenspan cult be getting just a little out of hand? I expect to read any day of plans to hang a portrait of the chairman over the President's desk in the Oval Office. How long before Greenspan's gloomy visage peers down at me in the arrivals hall at Washington Dulles International Airport? A bureaucrat, however talented, is just a bureaucrat: not infallible, not above criticism. And exactly how talented—if I may venture where Presidents fear to tread—is something that remains to be seen.

Sorry to shock you like that. Let me qualify this heresy at once. In most arguments about the state of the economy and the conduct of monetary policy, it is better to take Greenspan's side than his critics'. What the critics usually say is that the Fed has strangled the economy; that it has failed to see that structural economic change has eradicated inflation; that the economy would be growing at, oh, double-digit rates, easily, if Greenspan had only had the courage to take his foot off the brake.

What rubbish. The record of the 1990s, and especially the late 1990s, has been spectacularly good. It is sheer madness to be demanding even faster growth (and, presumably, even lower unemployment) than the economy has witnessed over the past five years. The only sane question to ask is whether this record has actually been too good to be true. And, with the full extent of the current slowdown still uncertain, it will be awhile yet before we know.

One thing we do know, however, is that we have had two Alan Greenspans, not one. Understanding this is helpful. The first Greenspan ran the Fed from 1987-96 before the second took over. Enough time has passed for the first Greenspan to be judged a great success, and for his methods to be reverse-engineered. The second Greenspan has also done well, on the face of it—but in truth, this new chairman is still learning on the job and hasn't yet worked out what is going on. This second Greenspan has no "method," as such. The first Greenspan was steady, predictable, and judicious; his successor likes a bet, springs surprises now and then, and works by instinct, not by the book. He may be a better central banker than the other one—but, to repeat, it is still early.

Consider the first Greenspan's term of office. Those years included a recession, but a mild one by historical standards. Overall, growth was smooth and steady; inflation stayed low. Most economists believe this combination was no coincidence. Usually, severe recessions follow spells of inflation, themselves caused by over-rapid growth. Bust follows boom. Avoid the boom and you avoid the bust.

There is even a policy formula that captures this wisdom. It is called the Taylor rule, after its inventor, John Taylor of Stanford University. Its simplest

form says: Set the short-term interest rate (the fed funds rate) equal to inflation, plus the long-term real interest rate, plus half of the excess of output over trend, plus half of the excess of actual inflation over your chosen target. Suppose inflation is 2 percent, the long-term real (inflation-adjusted) rate is 2 percent, the excess of output over trend is 3 percent, and your target for inflation is 1 percent. The simplest Taylor rule then tells you that the fed funds rate should be 2 percent, plus 2 percent, plus half of 3 percent, plus half of 1 percent, which equals 6 percent.

Why does this rule avoid boom and bust? Because, in effect, when output starts to grow very quickly, Taylor's formula treats it as a signal of future inflation. Interest rates go up before inflation starts to rise, nipping the problem in the bud. No boom, therefore no bust.

It seems to work. We know this because the Fed's interest-rate decisions between 1987 and 1996 conformed very closely, deliberately or not, to the simple Taylor rule. The secret of the first Greenspan's success, whether he knew it or not, was that he did what the rule said he should.

The second Greenspan abandoned the Taylor rule—or this simple version of it, anyway. Growth in output accelerated after 1996. The rule called for higher interest rates. They mostly stayed down. According to the Taylor rule of 1987-96, with its implicit inflation target of 1 percent, the fed funds rate should currently be 7 percent. This week, Greenspan cut it again, to 5.5 percent.

Nobody, so far as I know, is saying that the Fed should have jacked up interest rates this week. Such caution is partly because the slowdown is getting worse, and partly because the economy has changed in a way that nobody fully understands. At such times, rules get put on hold—or revised. If the long-term path of production has tilted sharply upward, there might be little or no excess of output over trend. And perhaps it is better to anticipate changes in output, as the Fed is trying to, instead of (as the simple rule advocates) merely reacting to them once they have happened.

WE HAVE HAD TWO ALAN GREENSPANS, NOT ONE, AS FED CHAIRMAN. UNDERSTANDING THIS IS HELPFUL.

Combining arguments such as these, you could probably rationalize what Greenspan is now doing in terms of an "adjusted" Taylor rule. In economics, the wiggle room never ends. However you look at it, though, the second Greenspan has gambled on an optimistic view of the new economy. We still do not know whether the gamble will pay off. The danger of a big bust this year is in proportion to the excess—if any—built up in the long boom that preceded it. By the same reasoning, blame a severe recession, if it comes, not on a failure to cut interest rates quickly enough now, but on a failure (however forgivable under the circumstances) to raise them far enough after 1996.

No doubt the second Greenspan is as able as the first, but he is struggling with much more difficult problems. For his effort, he deserves respect and even admiration, but not blind devotion. His actions, like those of any other bureaucrat, demand to be scrutinized and criticized—although it is best (to be fair to the apologetic President) that this be done from outside the Administration. And all of this applies to monetary policy, Greenspan's appointed domain. His views on other matters are just views—in themselves, no more valuable than the opinions of any other thoughtful observer. Sometimes less so.

This brings us to the chairman's surprisingly inept comments on tax cuts, which seem to have started a fiscal-policy arms race in Congress. Two weeks ago, I explained why the official budget surplus projections (just revised upward again) are extremely unreliable. This is a point that both Alan Greenspans used to emphasize. But now—can there be a third?—the chairman concludes that the surplus will be big enough to pay for tax cuts and to buy back the national debt. Maybe it will. But if this is true now, it was true as a general proposition before. Why change the line? Because of the new risk of recession? No, the chairman rightly rules that out: Fiscal policy is of no use for heading off recessions, he says.

Greenspan says he has started to worry instead about what will happen when all the debt has been bought back and the government has to invest the surplus in private assets, such as equities. Well, that would be a bad situation—but the issue is many years away at least, and in all likelihood will never arise. In the meantime, just as the President should refrain from commenting on monetary policy, so the Fed has no business opining on whether the economy needs debt reduction, tax cuts, or higher public spending. That is politics, not central banking.

Suspicions have arisen that Greenspan is expressing his party sympathies. These suspicions could undermine the Fed's reputation and, in the end, even threaten its operational independence. Greenspan committed an unforced error. The Fed is already overburdened without foreign entanglements. More proof that its chairman, contrary to expert consensus, is only human. ■

Clive Crook

Gloom Was All Right. Panic Is Another Thing

Until about a week ago, the past year's decline in stock prices had been a pretty orderly affair. That was good. Prices needed to fall, or at least to pause while the economy caught up. It mattered for the economy that, when this eventually happened, there would be no panic—just a gradual, thorough deflation of the tech-stock bubble, a more modest correction in the wider market, and a calm reappraisal of the prospects for equities, enough to bring investors' hopes into line with what the economy could conceivably achieve.

All was going quite well. The yearlong collapse of the NASDAQ market for technology stocks, which dropped from a high of 5,132 in March 2000 to roughly half that in recent weeks, was encouraging in a way—because it was greeted much more quietly than anybody would have dared think possible. Reality seemed to be dawning without too much distress. But in the past week or so, this steady realignment threatened more than once to become a rout.

The new turmoil is not confined to NASDAQ, which plunged to well under 2,000 at the start of this past week. The wider stock market has been in the grip of it, too. Reflecting this turmoil, and driving it, the mood on Wall Street changed. Cries of panic interrupted the gloom, as did the occasional whimper of capitulation. Pundits on CNBC experienced, oh, seconds at a stretch when they were at a loss for words. The economy arrived at a strange and frightening place.

One of the things that brakes a fall in stock prices under ordinary circumstances is confidence about the underlying value of the investment. The cheaper a stock gets, the more attractive it becomes, given the expected earnings of the company concerned. At today's prices, this cushion of value still looks, from certain angles, a long way down despite the 60 percent fall in technology stocks in the past year and despite the wider market's fall of more than 20 percent over the same period.

Tech-stock prices have merely been following the falling curve of projected earnings. In some cases, they still lag behind the curve. When traditional methods of valuation—less despised these days than they were a few months back—are considered, many of the companies on NASDAQ still look expensive. The risk that many companies will fail altogether has now been noticed. Even on the wider market, bargains are few and far between. Some of Wall Street's formerly exuberant analysts, including a few who predicted that NASDAQ would soar past 6,000 last year, now peer over the edge and say they see no bottom.

Reversals such as this are unsettling. So is something else. Many of the changes the economy has seen since the mid-1990s remain a matter of debate, but one is uncontested: Now that equities are so widely held in the United States, stock market wealth has become a primary engine of demand in the economy.

This was a troubling development, even before the latest bout of alarm. Last week, the Federal Reserve released figures showing the first decline in the net worth of American households for at least 55 years, from $42.3 trillion at the end of 1999 to $41.4 trillion at the end of 2000. Lower stock prices were to blame. The decline in prices continued after the turn of the year, so net worth will have fallen further; another big drop in prices, hence in household wealth, is possible.

Net worth influences the business cycle. A fall will encourage people to save more and spend less. Lower consumer spending, combined with lower industrial output as companies try to reduce their swollen inventories, would constitute a double-strength economic depressant. To make things worse, a drop in demand caused by falling wealth is hard to reverse

with lower interest rates. In these conditions, the Fed's power to turn the economy around may be less than people think.

Needless to say, a worsening economic slowdown driven by continuing falls on Wall Street is not inevitable. Just as the mood switched last year from euphoria to caution and then to gloom, just as it switched in the past week from gloom to despair, it can switch again. Investors might revive on the strength of a single positive sign, or for no reason at all. If the markets stabilize at something like their current levels, and the slowdown proves to be no more than a pause (both are possible), the United States can still have its soft landing. Investors (in the wider market, at least) will come out singed and somewhat wiser, but not destroyed. In fact, if all of this came to pass, they would still have big gains to show for, say, the past five years. But the danger of a much worse outcome is real. The economy's sensitive new dependence on the financial markets' mood has to be recognized.

No doubt it is rash to draw lessons from economic events that are still unfolding. After all, it is not *impossible* that NASDAQ will shortly cruise past 6,000, and all the bad outcomes contemplated here will again be regarded as ridiculous. It might be naïve to imagine that investors can learn such lessons in any case: History, it seems, teaches them only what they want to hear. Still, everybody else is being sober at the moment, sober to a fault. It is this column's turn to be reckless.

Lesson one, then, for the attention of Alan Greenspan and central bankers everywhere: Keep a safe distance from the bull-market claque. Wall Street poses the risk to the economy that it does right now because so many stocks were bid up too high in the first place. What drove them up was, among other things, an exaggerated optimism about prospects for the New Economy, and for technology firms in particular. Maybe the Fed should have raised interest rates earlier in the expansion, to keep a lid on the euphoria. That is debatable. A pre-emptive monetary policy of this sort would have been asking a lot of the Fed, politically, at a time of genuine uncertainty over how much the economy was really changing.

THE NET WORTH OF AMERICAN HOUSEHOLDS HAS DROPPED FOR THE FIRST TIME IN AT LEAST 55 YEARS. STOCKS WERE TO BLAME.

What seems much clearer, though, is that Alan Greenspan was wrong—in speeches and in congressional testimony—to weigh in so heavily on the side of New Economy optimists. Long-term growth in productivity probably has gone up in recent years, even if by less than the enthusiasts (the majority until recently) used to believe. The current vogue for regarding the New Economy as nothing but a fraud is as stupid as was the earlier foolish orthodoxy. Greenspan was right to say that something interesting was going on, but he was dead wrong to endorse the zealots, or (if you want to be charitable) to let his comments be seen that way. In effect, he cheered on the tech-stock craze, helping to drive NASDAQ and the wider market to unnerving heights, thereby adding to the current danger. Greenspan could have been much more circumspect, and he should have been. Central bankers should attenuate the extremes of market sentiment, not amplify them.

Lesson two is directed at ordinary intelligent investors—pointlessly, as noted, but here goes, anyway: Keep a safe distance from the bull-market claque. Especially, ignore advice from anybody with a financial stake in a rising market. Web sites, magazines, and television programs pitched at amateur investors all depend on advertising revenues generated by the enthusiasm of investors for trading stocks, and therefore, in the end, by a rising market. Many of these sources exist to celebrate Wall Street, not analyze it; to gull investors, not inform them.

Many investment-bank stock-pickers are first and foremost professional market-boosters. Perhaps their firms hope to retain as clients the companies whose stocks they analyze, in which case talking down the shares would be unwise. Or maybe they have an interest in a thriving market for initial public offerings: Underwriting IPOs in a rising market is a lucrative business, and NASDAQ's collapse brought it to a standstill. As soon as you understand these interests, it becomes clear why so many technology companies with dubious prospects were greeted in the analysts' reports not just credulously, but rapturously, or why every setback was denied or ignored.

Warren Buffett's annual letter to shareholders of his company, Berkshire Hathaway, makes better reading. This year's report, released last weekend, is especially apt. The legendary "traditional" investor, who has made billions for himself and his shareholders by buying fundamentally undervalued companies, was held up to ridicule last year for missing out on the technology boom. This year, to the sound of a crashing NASDAQ, he could point to doubled earnings and a 70 percent rise in his company's stock price. He said that Berkshire has "embraced the 21st century by entering such cutting-edge industries as brick, carpet, insulation, and paint." And Buffett attacked the Wall Street promoters of "bubble companies, entities designed more with an eye to making money *off* investors rather than *for* them." He's right. Read it, dot-com casualties, and weep. ■

Clive Crook

THE SUMMIT THAT WAS WORSE THAN USELESS

The laws of democratic politics will always require governments to devote most of their intellectual resources to posturing—specifically, to claiming credit they do not deserve and denying responsibility that is rightly theirs. It is the way of the world, and there is little point in complaining about it. As a rule, all the boasting and evading alters nothing that matters and does no great harm. Now and then, the habit gets out of hand and threatens to cause real damage. In recent days we have seen two striking examples.

The first was the economic summit in Genoa, Italy. In terms of substance, the event yielded nothing. George W. Bush and the leaders of the other G-8 countries reannounced with great fanfare a timid medical-aid plan for Africa that officials had put together earlier. They issued a communiqué full of standard-issue global-economy platitudes that had also been put together by officials in advance. As far as policy is concerned, nothing would have been any different if the meeting had never happened.

But as things turned out, this summit was worse than useless. It provided the venue for another big anti-globalization protest, which got seriously out of hand and left one protester shot dead by the Italian police. A fine spectacle: The leaders of the rich democracies (plus Russia) feast and flatter each other behind their razor-wire barricades while thousands of police do whatever it takes, and then some, to suppress dissent. The event's only rationale was public relations. It became a public relations disaster.

The great cost of the event and the security surrounding it, the damage to property, the injuries and the death, all these are bad enough, but there is lasting political harm as well. Not for the first time, the G-8 governments have put the case against globalization more eloquently than the protesters ever could. From the anti-capitalists' point of view, the images from Genoa sum things up perfectly: on one side, we, the people; on the other, they, the global power elite, disdainful of the masses, ever willing to repress them when the need arises. It is a gross caricature—but an effective one, nonetheless.

At meetings such as the one in Genoa, the presidents and prime ministers are in claiming-credit mode. Look at us, take our picture, see how impressive we are, leaders of the New World Order. That is one kind of posturing. The New World Order also comes in handy for the other kind, denying responsibility—as in, "We cannot do what we promised to, or what you, the voters, would like us to, because the rules of the new global economy forbid it." Raise the minimum wage? Globalization makes it difficult. Regulate this, curb that, prohibit the other? Impossible, it would make us uncompetitive in the new world economy, or violate the rules of the World Trade Organization. Markets, all this seems to say, overrule democracy.

So when it comes to the world economy, whether governments are claiming credit or denying responsibility, their message is the same: They affirm the anti-capitalists' worldview. A new international order is emerging, the leaders imply, which requires supranational leadership of a not fully democratic kind. The only difference is that governments regard this new order as desirable (when claiming credit) or inevitable (when denying responsibility), whereas the protesters regard it as neither.

Governments are right to say that globalization is desirable. The evidence is overwhelming that economic integration in the aggregate makes people, including the poor, better off. But they are wrong to say that globalization is inevitable. If they chose, they could slow it down, or even stop it. Most important, they are wrong to agree with the anti-capitalists that once you have chosen globalization, your other political choices shrink to nothing. The

truth is, they narrow in some respects and widen in others. But globalization is not the death of democratic politics. Compare the United States with Britain, or France, or Japan—all open, closely integrated economies, with widely varying policies on taxation, public services, regulation of every kind, and with no sign that these differences are disappearing.

A government's economic options are narrowed not by international trade or flows of capital, but mainly by certain economic facts of life. Print too much money, and you get inflation. Borrow too much, and you go bust. Make welfare too generous, or raise taxes too high, and you discourage effort. Overregulate, and you stifle innovation and produce the wrong things. But these rules work just the same whether your economy is open or closed. Also, they bind loosely enough to leave plenty of room for politics. Isn't that obvious? If much of Europe gets along all right with an overall tax rate of 50 percent, compared with America's 30 percent, that may be because Europeans prefer it that way: They get better public services in return. Americans, on the other hand, want to decide for themselves how to spend their income. That is politics—and globalization has nothing to say about it.

When governments agree with the anticapitalists that globalization outvotes everybody, it is the governments that are wounding democracy, and badly. When they lead voters to conclude that national politics matters less than it used to, this is no harmless evasion of responsibility. If citizens come to think that they must choose between democracy and globalization, and, given this false choice, vote against globalization, the damage in human welfare will be enormous. If, instead, they abstain from politics, not bothering to vote or pay attention to what their elected representatives are up to, the harm will be different but hardly less worrying.

The Genoa meeting was not the only recent reminder of the damage that political posturing can do. Another was this week's agreement in Bonn to revive the Kyoto Protocol on greenhouse gases, despite America's decision that it will have nothing to do with the plan.

WHEN GOVERNMENTS SUGGEST THAT GLOBALIZATION OUTVOTES EVERYBODY, THEY ARE WOUNDING DEMOCRACY, AND BADLY.

The Kyoto saga has been an epic of posturing from beginning to end. The previous Administration signed it, knowing it would be politically and economically impossible to implement: Bill Clinton and Al Gore wanted to claim credit for "saving the planet." Then, as talks on putting the agreement into force continued, Europe's governments refused to agree to changes that could have made the plan more acceptable to America: Now it was their turn to claim credit for saving the planet, and (how much sweeter) over American objections, too. This week, Europe's governments have agreed to some of the flexibility (notably on how to count forests as "carbon sinks") that they refused on their honor to countenance earlier. This was necessary to get Japan to sign up, and Japan's joining was, in turn, necessary to achieve the main objective: isolating America.

The result was a diplomatic triumph for Europe—according to European newspapers, anyway. America is shunned by all nations, they exulted, so the planet will not die. Yet the agreement is worthless. Even if it were fully implemented, the effect on projected changes in temperature by the end of the century would be negligible. And it will not be fully implemented. Some countries, notably Japan, will probably fail to ratify it, and many of those that do ratify it will not try very hard to meet its targets. Still, all this is beside the point. The main thing is that Europe's environment ministers had simply fabulous press.

The Bush Administration is posturing as well, in its own way. The President, too, is playing the game. The patent uselessness of the Kyoto plan allows Bush to deny responsibility: The Senate would never have passed it, so he had no choice but to abandon it, he says. True. But the Administration says that global warming is a problem and something must be done to curb carbon emissions. Well, what exactly? Why is the Administration taking so long to enlighten the world on this subject? Perhaps because it has nothing to gain and much to lose, PR-wise, by hurrying to deal with an issue it only pretends to believe is important.

Canada, host of next year's summit, plans to stage a smaller production in an inaccessible spot. Less grand is good, but better would be to shut these summits down altogether. Rather than arranging an annual event, governments should hold meetings less frequently, and discuss specific issues as the need arises. As for the Kyoto Protocol, that is going to be discarded sooner or later whether the governments involved like it or not—which is fine, because even if it were not discarded it would make next to no difference to global warming.

Designing a workable, inexpensive plan for curbing carbon emissions over the course of the century—which all governments say they want—would not be very difficult, technically. But it would demand a genuine sense of purpose, together with less pretending, less grandstanding, less preening, and much less righteous indignation. When you look at it that way, it all seems pretty hopeless. ■

Clive Crook

Blame America? What Self-Loathing Rubbish

The notion that America and its friends are partly to blame for the attacks of September 11 is being seriously discussed in enlightened circles in the West, and in its more sober and sophisticated journals. The suggestion is that the United States and its allies have spent years flexing their economic muscles and fueling the rage of impoverished Muslims and other oppressed peoples of the developing world. Now they must bear some of the responsibility for the backlash. "In a way," it is argued, "we brought this on ourselves."

Do the people who say this have a point? In my view, they should not be dismissed lightly: No, to paraphrase Dorothy Parker, they should be hurled across the room with great force.

In the United States, where even the tenured radicals ought to know better, there is a good deal of agonizing over the arrogance of American economic power, the tyranny of Western cultural imperialism, the immiserizing effects of global capitalism, and so on. In Europe, obviously, hands are being wrung even more fervently. You expect such nonsense from the imperviously deluded Left, and even from the mainstream media in countries such as, oh, France? But today you can see collective guilt and self-loathing in many more places than you might have expected.

Certainly, we in the West need to think about the fact that we are hated in much of the Middle East and in other parts of the Third World. We need to understand why, and we need to do something about it: In other words, there is a propaganda war to fight. And I will accept another qualification, concerning American policy toward Israel and the Palestinians. Israel under the leadership of Ariel Sharon does not deserve the full measure of support that the United States instinctively wants to provide (though it remains true now, as ever, that Israel's government is the only democratic law-based regime in the region). Greater efforts to push both sides back toward the prospect of a peace settlement—and that means, among other things, leaning on Israel—would be in America's interests, and everybody else's.

Still, it ought to be obvious that shifts in foreign policy will do little or nothing to assuage the fanatics who attacked on September 11. They are quite beyond reason or compromise. And none of this implies that there's an atom of merit in the broader anti-American, anti-Western, anti-capitalist indictment that has been given a new airing, and has been taken so seriously, in recent days.

The most pernicious myth, because it goes to the heart of the way we organize our societies, is the idea that international capitalism is itself fundamentally unjust. The charge is that economic integration—globalization, as it is now called—entrenches poverty in the developing countries by locking its people into dependence on, and subservience to, Western economies. Free trade is not "fair trade," people say, because the terms of exchange are rigged against the poor countries' interests. International capitalism, it is argued, actually needs poverty in the Third World in order to thrive. Those held down in penury can hardly be blamed for wanting to overthrow their slave masters.

It is a kind of miracle that this idea survives as it does, when even the most casual look around the globe refutes it. In recent decades, which have been the fastest-growing developing countries? The answer, notwithstanding recent difficulties, is South Korea, Taiwan, Malaysia, Thailand, Singapore, China, and others. Poverty has fallen faster in these countries in the past 30 years than ever before in human history. What do these economies have in common, aside from being in Asia? Not much, in fact—except

that they have all embraced globalization. Each in its own way, they have used export markets to develop their industries, utterly confounding the idea that trade keeps poor countries poor.

On the other hand, which are the least-successful economies in the world? Look to Africa, and to many parts of the Middle East that have no oil—not forgetting failed states such as Afghanistan, of course. What do all these have in common? Again, one main thing. For years, they deliberately rejected economic integration with the West, and capitalism too, for that matter. Economics is rarely clear-cut about anything, but here for once is an exception: Plainly, incontrovertibly, it is not globalization, but lack of globalization, that keeps the world's poorest in poverty.

By the way, Islam as such is not the problem, either. Egypt, Libya, Syria, and the others have not been condemned to stagnation by their religious faith. Malaysia has combined Islam with rapid growth and dawning economic modernity; so has Turkey. What has crushed the economic prospects of the Arab states is not Muslim beliefs—or lack of Western aid, please note, because some have had plenty of that—but socialist economic planning based on closed economies and rampant statism. If you want to know how anti-capitalism works in practice, you no longer have the Soviet Union to examine, but North Africa and the Middle East are a reasonable substitute. The public sector's share of the region's economies is now the highest in the world.

Up until the mid-1980s, these countries got by on oil revenues, thanks to OPEC. Even those nations without oil benefited, either through financial support from the Gulf states or from cash sent home by migrant workers. But when the price of oil tumbled, they were stranded. Thanks to their rejection of trade, they had developed no industries to take up the slack. The fact that the region's economies all have tiny domestic markets made trade even more crucial. Without overseas markets, there was no way to diversify. Per capita incomes actually fell between 1985 and 1995. The lack of competitive economic development has created chronically high unemployment—it averages around 15 percent, and especially affects young, comparatively well-educated, urban men. If you are trying to explain poverty, rage, and frustration among the youth of the Middle East, don't blame global capitalism—blame the ruinously incompetent economic policies of the region's governments.

THE MOST PERNICIOUS MYTH IS THE IDEA THAT INTERNATIONAL CAPITALISM IS FUNDAMENTALLY UNJUST.

A different line of attack on the West's influence points not so much to the imaginary economic crimes of international capitalism as to the broader evil of American cultural hegemony. America and the West expect all the world to share their values of materialism and narrow individualism, goes the argument. People in Third World countries, especially in the Middle East, resent that and reject it. Cultural slavery is no better than the other kind.

This is a much vaguer charge, and therefore harder to rebut—but there are several things to say. One is very obvious, or should be. It is a gross abuse of language to talk of "slavery" or "hegemony" when people subject to this supposed oppression are free to decide for themselves which values to exalt. In America and the West, people do have that freedom; in much of the Middle East, they do not. That is worth remembering. But the point in any case is that America and the West have no quarrel with people who, given the choice, freely reject Western "materialism" or "individualism." Nobody is going to be forced to drink Coke or watch Disney if they don't want to. America's only quarrel is with people who want to kill Americans for being American—and it is legitimate to object to that, isn't it?

A problem does arise for the West in dealing with regimes that do not threaten outsiders and are mainly interested in oppressing their own people. Here, as you might expect, the Left wants it both ways. America is criticized both for attempting to export its values (cultural imperialism) and for standing aside while corrupt tyrannies and pseudo-democracies, such as those running many Arab states, oppress their citizens (unilateralism). In any given case, the United States is quite likely to be doing one or other of these two, so it is more or less guaranteed to be in the wrong.

What should it do, in fact? My vote is for enlightened unilateralism, let us call it. By all means, America and the West should make the case for Western values. (That is not too hard. The United States does it eloquently merely by going about its business: Ask the queue of immigrants of all faiths.) Certainly, it should not apologize for its values or be embarrassed by them.

But it is probably a mistake to do more than exemplify the virtues of our political and economic culture merely by living them. Sadly, our best course is probably to leave benighted regimes in place, neither supporting them nor actively opposing them, until their own people demand a change. Unless, of course, those regimes decide to threaten the West, for instance by sponsoring or sheltering terrorists. That, we must always make clear, is a lethal mistake, and the point where the West's tolerance abruptly stops. ■

Clive Crook

BIN LADEN OR NO, IT'S FISCAL POLICY AS USUAL FOR CONGRESS

Three months on, nobody can say that Congress has let terrorism interfere with business as usual. Despite the slowing economy and the shock to confidence of September 11 and its aftermath, lawmakers have spared no effort of partisan squabbling or of bowing down to narrow interests: Against the odds, members of Congress have delayed for weeks their long-promised and (so they say) urgently needed economic stimulus bill. Maybe they'll do something soon. The fact is, they should have passed a simple and effective stimulus measure in days.

On trade policy, lawmakers have proved no less stalwart. Most of the world's governments recently agreed to set aside their differences on the issue and to start a new round of talks on trade liberalization—a necessary gesture of solidarity, they believed, and a vote of confidence in international capitalism. You might have expected the United States to be glad about this. Certainly, feats of negotiating skill from Robert Zoellick, the U.S. Trade Representative, were needed to secure the deal. But Congress is not so easily swayed.

As this article went to press, lawmakers were threatening to throw the trade initiative back in the world's face by refusing to grant the Bush Administration trade-promotion authority. This time, more plainly than on previous "fast-track" votes, the problem has not been concern about the environment or labor standards in developing countries, or any other superficially plausible excuse for restricting trade. Resistance among Republicans and Democrats alike springs from outright protectionism: the defense of narrow producer interests at the expense of the economy as a whole. Apparently, it will take more than Osama bin Laden and his followers to test the craven irresponsibility of America's elected representatives.

So far as the awaited fiscal package is concerned, congressional Republicans, encouraged by the Bush Administration, are mainly to blame. Some conservatives are keen to seize any opportunity to cut taxes, especially business taxes, even if more-pressing goals get sacrificed, as happens now and then. Cutting taxes when revenue permits is an excellent idea, whatever Democrats may think—not for demand-boosting reasons, not even for "supply-side" incentive-spurring reasons, but simply because lower taxes are desirable in themselves. The national income does not belong to the government, so the more of it people are allowed to keep and spend for themselves, the better. But sometimes the government does need to boost the economy in order to ward off, or to ease the pain of, recession. When countering a recession is the top priority, cutting taxes has to give way to more-effective measures.

Fiscal policy must then be aimed at short-term demand, not long-term anything. During an economic slowdown, it is demand that is lacking. Firms already have too much productive capacity, relative to demand—that is what "recession" means—so stimulus measures that grant tax breaks for new investment, which would expand capacity even further, are beside the point. True, if investment rose because of such incentives, demand would rise as well, as a byproduct. But it would go up much less per dollar than would be achieved by a direct injection of demand, such as an increase in public spending aimed at low-income consumers. And if demand from consumers is lacking, tax incentives for investment may fail to spur investment, and hence demand, at all.

As it happens, much of the business-tax relief envisaged by congressional Republicans, following the Administration's lead, does not even pretend to promote investment. Suspending or repealing the corporate alternative minimum tax, for instance, would simply give cash unconditionally to the firms affected. American companies in general are not short of cash at the moment. Many of them are flush with

cash. Giving them more, with no requirement to undertake new investment, packs almost no recession-curbing punch. In the end, it amounts to a long-delayed income-tax cut for the relatively prosperous owners of the companies. In both respects—the delay in passing a bill, and giving the relief to the rich, who are likely to save rather than to spend a good part of their tax cut—the idea might have been calculated to have the minimum anti-recession effect.

But is additional public spending any better? Not according to R. Glenn Hubbard, chairman of the president's Council of Economic Advisers. In a recent article in *The Washington Post*, he said the idea that extra public spending would stimulate the economy was a "major fallacy" (not even a minor fallacy). That was why the Administration was backing tax cuts, especially for business. CEA chairmen have made some strange pronouncements over the years, the demands of politics being what they are, but this one deserves a prize.

You can in fact imagine circumstances in which higher public spending would fail to increase demand in the economy. If the economy were running flat out, with no spare capacity, then an extra dollar of public spending would necessarily "crowd out" a dollar of private spending. Self-evidently, this is not America's situation at the moment: Congress is discussing fiscal stimulus precisely because the economy has a great deal of spare capacity.

Alternatively, some economists would argue that higher public spending crowds out private spending in another way: by leading people to save more in anticipation of higher taxes in due course. But the evidence says that this effect matters, if at all, only when the budget deficit is already very high—which America's is not. Also, if this theory applied today, it would deny the demand-stimulating power of tax cuts, which Hubbard is keen on, just as much as it denies the demand-stimulating power of spending increases. Both policies reduce the surplus (or add to the deficit, as the case may be); if either gives rise to offsetting changes in private spending, both must.

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In short, the CEA chairman is talking rubbish. Somebody, perhaps, ought to be asking whether any kind of fiscal stimulus is really necessary. Recent figures, after all, point to an early recovery. If Congress dallies much longer, it may find itself—not for the first time—stimulating an economy that is already surging back. On balance, though, it is probably better to pass an effective bill and find that it is not needed than to pass an ineffective one, or none at all, and find that it *is* needed. Almost every politician is saying that a bill must be passed. Fine, but if stimulus is to work, the bill ought to concentrate single-mindedly on fast and temporary support for demand.

Should a payroll-tax holiday be part of such a bill? There are doubts about how quickly this could be arranged. And its effects on demand, though far stronger than an unconditional cut in business taxes, are still limited by the fact that the benefit goes to many households that are prosperous enough to save the gain in income rather than spend it.

A much better idea would be to increase temporary support for the unemployed. On Wednesday, House Republicans offered belatedly to renew the Trade Adjustment Assistance Act with this aim in view, and to write similar extensions of unemployment assistance into their stimulus bill. The amounts involved are still too small, but the direction is right. This approach meets every test of effectiveness. The money goes directly to people who are short of income, so it is likely to feed through quickly, and nearly one for one, into higher spending. It meets pressing needs, directly protecting those worst affected by recession, and helping to shore up confidence where it is weakest. And it is self-adjusting to the severity of the slowdown. If the recession is mild, the rise in unemployment will be small and short-lived; the rise in the cost of benefits tied to unemployment will be correspondingly modest. If the recession is deep and prolonged, many more people will be thrown out of work; the rise in the cost of benefits, and the value of the policy in terms of fiscal stimulus, will automatically be greater.

New measures to help the unemployed might also help to answer doubts about the new trade round—which, once the recession is over, will have a bigger influence on the health of the American economy, and the world economy, than anything in the stimulus bill. The only valid concern that trade skeptics have about the forthcoming round, buried under a mountain of specious charges and propaganda, is that in promoting trade, the new round will also promote economic change. In other words, more workers will be displaced from shrinking industries—and many of those workers will struggle to find work at the same or better pay in the new, faster-growing industries that will take their place.

More-generous measures to cushion the fall in income caused by unemployment or by taking up new work at a lower wage make sense in any case. Passed now, they would soften the recession and advance the cause of liberal trade as well. Is that so difficult? ■