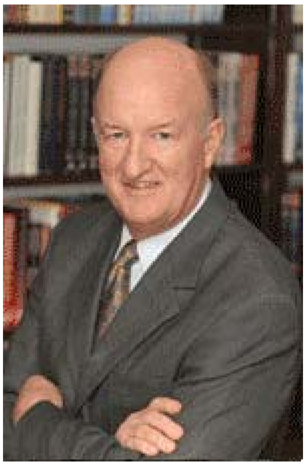
Consumers Don't Drive the Economy, Producers Do



In Commerce Secretary John Bryson's announcement that the nation's Gross Domestic Product (GDP) grew at an annual rate of 2.5% last quarter, he came close to disclosing the real driver of the economy: producers:

> In spite of headwinds hitting the U.S. economy, today's GDP report — the ninth straight positive quarter — reflects strong consumer spending and export growth and *continued investment by American businesses* (emphasis added).

But then he had to go and spoil it all by touting the Keynesian response to lack of jobs and turning to shill for more government spending:

> Despite today's encouraging numbers, we must do more to create jobs. That's why it's critical that Congress act to pass the measures in the president's Jobs Act.

It's the Keynesian approach that puts the matter upside down, but continues to be the only ideology considered as a solution: demand creates supply. If that is so, then putting spending power into the hands of consumers will drive the economy. History shows that that leads to all kinds of mischief, including taking of money from those who earned it and giving it to those who didn't, all in the name of "fairness" and "economic justice." The fact that the Keynesian approach doesn't work, never has worked, and never can work, doesn't bother the statists who favor more government, regardless.

In fact, it was Jean-Baptiste Say who taught that supply (or production) creates its own demand. Scottish economist James Mill (father of John Stewart Mill) explained it this way: "Production of commodities creates, and is the one and universal cause which creates a market for the commodities produced." But Say merely extended the law taught by King Solomon in Ecclesiastes 5:11: "As goods increase, so do those who consume them."

As pointed out by Austrian economist Mark Skousen (pictured above), GDP as measured by the Commerce Department is faulty in that it only counts final consumption and fails to include the value of intermediate steps of production: "The truth is that consumer spending does not account for 70 percent of economic activity and is not the mainstay of the U.S. economy. Investment is!" He explains:

> Business spending on capital goods, new technology, entrepreneurship and productivity are more significant than consumer spending in sustaining the economy and a higher standard of living.
>
> In the business cycle, production and investment lead the economy into and out of a recession…

Skousen created the GDE (Gross Domestic Expenditures) to measure total spending in the economy at all stages, which is more than double the Commerce Department's GDP, and which shows consumer spending to be less than a third of GDE, while production of goods and services is more than half. He concludes that "Thus the truth is just the opposite: Consumer spending is the effect, not the cause, of a productive healthy economy." Skousen concludes:

> Granted, the ultimate function of business activity and entrepreneurship is to fulfill the needs of consumers, and the most successful firms are those that satisfy their customers. But more important, who discovers the new, improved products that consumers desire? Who is the catalyst that determines the quantity, quality, and variety of goods and services? Did the consumer come up with the idea of personal computers, SUVs, fax machines, cell phones, the internet, and the iPhone? No, these technological breakthroughs came from the genius of creative entrepreneurs and the savers/capitalists who funded their inventions.

And so when the Commerce Department reported that the economy expanded at an annual rate of 2.5% during the third quarter, it's helpful to remember that this is only the end result of the saving, investing and risk-taking by business owners. When the *Washington Post* reported that "economists believe that growth in consumer spending, which accounts for 70 percent of economic activity, will be restrained until incomes start growing at healthier levels, which is unlikely until hiring picks up," it is missing the point that hiring will only pick up when the economic environment appears to be favorable enough to entrepreneurs to put their capital at risk to create and build the things they hope consumers will want to buy, and not the other way around.