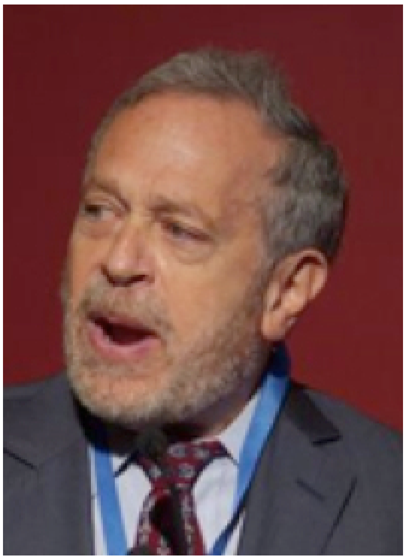
Why Reich Is Wrong



When former Labor Secretary Robert Reich offered his solutions for ending the Great Recession in the New York Times, he repeated the same errors expressed in a CNBC debate the week before.

Reich appears to have all the credentials for knowing what he is talking about: degrees from Dartmouth College, Yale Law School, and a Rhodes Scholarship to Oxford University. Having served as a law clerk to the chief judge of the U.S. First Circuit Court of Appeals and then assistant to the U.S. Solicitor General, followed by an appointment by President Jimmy Carter as Director of Policy Planning at the FTC, most would accept his opinions and suggestions for ending the recession as useful and relevant.

An early indicator that something might be wrong with his thinking, however, was revealed in his blog in April, 2008, when he publicly announced his support for Obama in the presidential election. He said that "although Hillary Clinton has offered solid and sensible policy proposals, Obama's strike me as even more so:

> His plans for reforming Social Security and health care have a better chance of succeeding. His approaches to the housing crisis and the failures of our financial markets are sounder than hers….
>
> He has rightly identified the armies of lawyers and lobbyists that have commandeered our democracy, and pointed the way toward taking it back….
>
> Finally … his life history exemplifies this, as do his writings and his record of public service. For these … reasons, he offers the best possibility of restoring America's moral authority in the world.

In his *Times* article, Reich admits that much of what the Obama administration has done to boost the economy hasn't worked, pointing out correctly that the private sector isn't generating anything like the number of jobs needed just "to keep up with the growth of the potential work force":

> The national economy isn't escaping the gravitational pull of the Great Recession. None of the standard booster rockets are working: near-zero interest rates from the Fed, almost record-low borrowing costs in the bond market, a giant stimulus package and tax credits for small businesses that hire the long-term unemployed have all failed to do enough.

But then he reveals, not what's wrong with the economy, but what's wrong with his thinking about the economy: "Consumers no longer have the purchasing power to buy the goods and services they produce as workers; for some time, their means haven't kept up with what the growing economy could and *should* have been able to provide them." (Emphasis added.) And he further exposes his lack of understanding of basic economics by adding: "Even if nearly everyone was employed, the vast middle class still wouldn't have enough money to buy what the economy is capable of producing."

The problem, he says, is the rich. They don't spend enough by themselves to keep the economy rolling, and the best thing to do is to relieve them of their wealth and give it to those who didn't earn it, who are much more likely to spend it buying the goods they are producing. Reich says: "The rich don't … invest their earnings and savings in the American economy…. They send them anywhere around the globe where they'll summon the highest returns." Furthermore, "the rich also put their money into [hard] assets [such as] commodities and real estate."

Then Reich dusts off the myth that only such redistribution of wealth got the country out of the Great Depression: "There is only one way back to full recovery: *through more widely shared prosperity*." (Emphasis added.) From that underlying provably false assumption, Reich offers his solutions to ending the Great Recession: exempting the first $20,000 of income from payroll taxes and paying for it with an additional tax on incomes over $250,000.

Early childhood education "should be more widely available, paid for by a small 0.5 per cent fee on all financial transactions. Public universities should be free; in return, graduates would then be required to pay back 10 per cent of their first 10 years of full-time income."

He offers something called "earning insurance" for workers who lose their jobs and have to settle for positions that pay less, and would be paid "half the salary difference for two years [which] would probably prove less expensive than extended unemployment benefits." He concludes that these are "policies that [would] generate *more widely shared prosperity* … and that's good for everyone." (Emphasis added.)

Peter Schiff, one of those "rich" entrepreneurs who is Reich's target (he is the founder of Euro Pacific Capital), explains the problem with this thinking: "Reich believes that the cart pushes the horse. In his worldview, businesses produce goods and services simply because consumers spend. Therefore, anything that increases spending fuels growth." But that is exactly backwards. It takes capital formation, and the incentives only provided by a free market (which rewards success by providing products and services that customers need and want and are willing to pay for, and punishes failure to provide such products and services), to create production. Schiff puts it neatly: "capital formation must precede production, which then allows for consumption."

Schiff adds:

> Every consumer either lives off his own productivity or the productivity of someone else. When individuals work, the wages earned result from the productivity of [their] labor. The ability to consume is directly related to the production of goods or services that result from one's efforts….
>
> In the Soviet Union, everyone had a job, yet workers had to stand in line for hours for basic necessities….
>
> If stimulus could produce demand, then no nation would be poor…. African poverty would be wiped out if African governments simply printed money more freely. Africans are not poor because they lack currency to spend [consider Zimbabwe]; they are poor because their governments inhibit production, deny [private] property rights, abrogat[e] contracts, prevent the accumulation of capital, and nationaliz[e] profits.

Schiff says that Reich should call for greater savings by reducing taxes on the rich, allowing them to invest in the new business ventures that are the driving force behind new jobs and higher employment.

Economist Thomas Sowell agrees with Schiff:

> What would probably get the economy recovering fastest and most completely would be for the President of the United States and Congressional leaders to shut up and stop meddling with the economy … [but] true believers [like Reich] have to believe that it is only because [government intervention and redistribution efforts haven't] been tried long enough, or with enough money being spent.

Investors.com said on September 3 that "all the actions this government has taken … haven't 'saved or created' 3.8 million jobs, as claimed. Instead, they've destroyed millions of jobs. But the administration remains clueless, hinting that it may seek another "stimulus" costing billions. This bunch is either willfully doing damage to the U.S. economy, or [is] completely incompetent.

With Robert Reich's credentials, it's hard to believe that he is clueless or incompetent.

Photo: Robert Reich