

Production, Not Consumption, Drives the Economy

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We are barraged these days with claims about which is the better way to stimulate the economy. Where some want to give tax rebates, others want to cut marginal tax rates. Where some place most emphasis on increased government spending, others place most of the emphasis on reduced taxes. To be sure, one might well doubt that any form of stimulus is necessary in the first place. Nonetheless, behind these debates lies an important principle about the source of wealth creation and the impact of government, for good or for bad, upon economic progress.

This principle is that supply and not demand is the fundamental source of energy in the economy. The simple fact of the matter is that production must take place before consumption becomes possible. The primary economic task is getting things produced. Getting things consumed is a secondary matter. Consumption is relatively passive or reactive in the economic process. The active positions of economic leadership reside on the production side of the economy. What is of central importance is the strength of incentives that people have to invest in productive enterprises. The chief forms of stimulus in this respect lie in having low taxes and mild regulations.

The truth that production precedes consumption faces us all the time, even if we don't think about it. Consider such a simple thing as buying a Christmas tree. Perhaps you go to a farm where you can cut your own tree. The tree you cut was planted several years ago. Consumption today is possible only

because several years ago someone invested capital to finance a plan of production that would allow people to harvest Christmas trees now.

What is true for Christmas trees is true for all consumption. Everything that you buy has become available because other people made plans sometime in the past to produce those things. For some things, the lapse of time is relatively short. The bread you buy in winter might have come from flour milled last spring. For other things, the lapse of time can be quite long. The hickory table you bought might have been produced from a tree planted 40 years ago.

There is a sharp economic difference between a program to stimulate production and one to stimulate consumption. The stimulation to production that results from low taxes and mild regulations is genuine, and will result in higher income and larger consumption in future years. The stimulation of consumption is false and illusory, and at best will bring momentary gains in consumption at the price of a long-term loss.

The time lag between production and consumption means that increased consumption today can be secured only by consuming capital, which diminishes wealth and future consumption. Suppose, for example, that a good number of people suddenly decided that they wanted to have two Christmas trees this year, perhaps because the government decided to stimulate consumption through tax rebates or credits. Tree farms will not have enough mature trees available to serve this larger demand. To some extent this larger demand will be curbed through increases in the price of trees. To some extent, though, it will be met through some harvesting of immature trees that otherwise would have been

harvested next year. The increased consumption of trees this year takes place through a consumption of tree capital, which reduces the volume of trees that will be available next year. When next year arrives, the price of trees accordingly will be higher because even fewer trees will be available due to the preceding stimulation of consumption.

If we want to explain the availability of consumer goods today, we must look to production decisions that were made years ago. If we want to look to the consequences of changes today to the incentives to produce, we must look to the future and not to the present. The driving force in our economy comes through production. Entrepreneurs provide the economic leadership that results in goods being available to consume.

Demand will always exist. This does not mean that anything and everything that is produced will find a market. Producers may produce things that consumers don't want to buy. Even the infamous Edsel, however, was not produced for long. In free markets, producers have strong incentive to produce what consumers want to buy, even if they do not have crystal balls that ensure success.

By strengthening or weakening the incentives to produce, policy can influence economic vitality. Sound public policy is that which allows the supply side to flourish. It is this kind of policy that allows consumers to flourish. Policies that aim directly to stimulate consumption, as in various types of tax-and-subsidy programs, impair production and weaken economic performance.