THE ECONOMIC SITUATION

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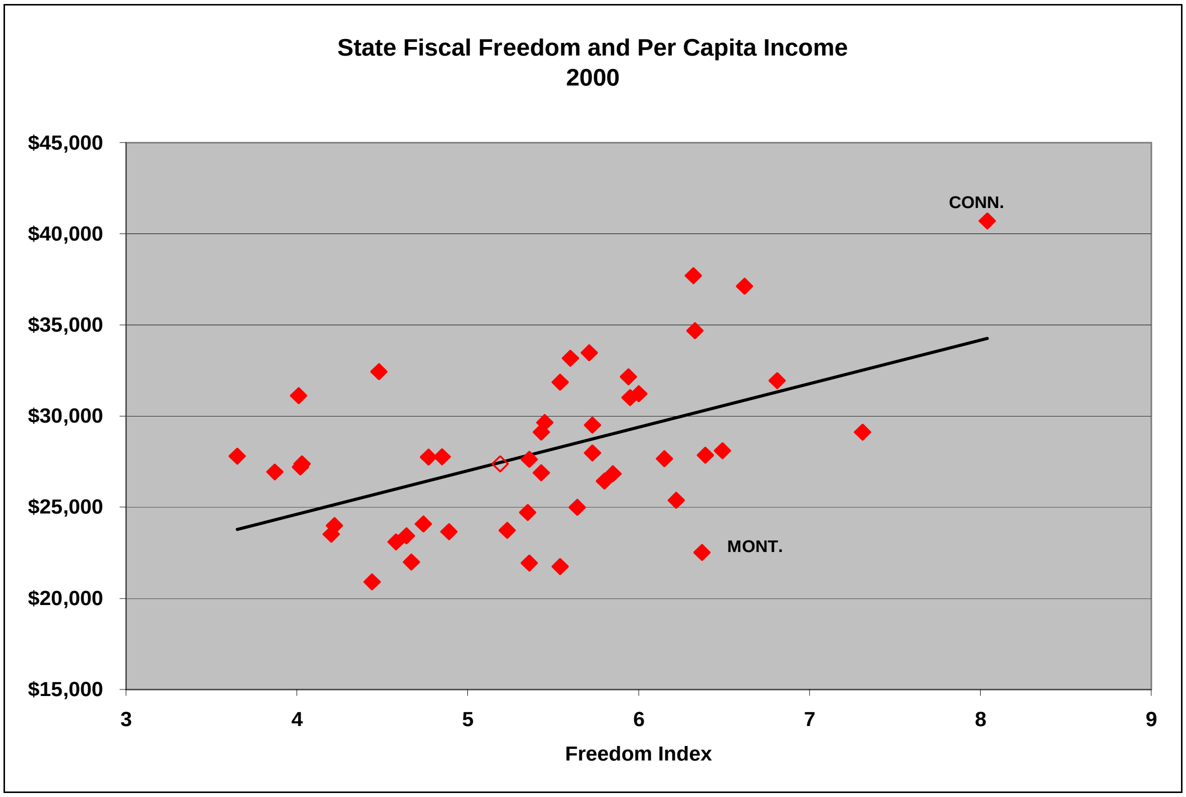
June 2007
Correction & Update

- **Economic freedom maps to growth in state product, but not to income.**
- **Money still calls the tune for the latest Industrial Production data.**
- **How Rich’s became cool.**

Let’s get it right.

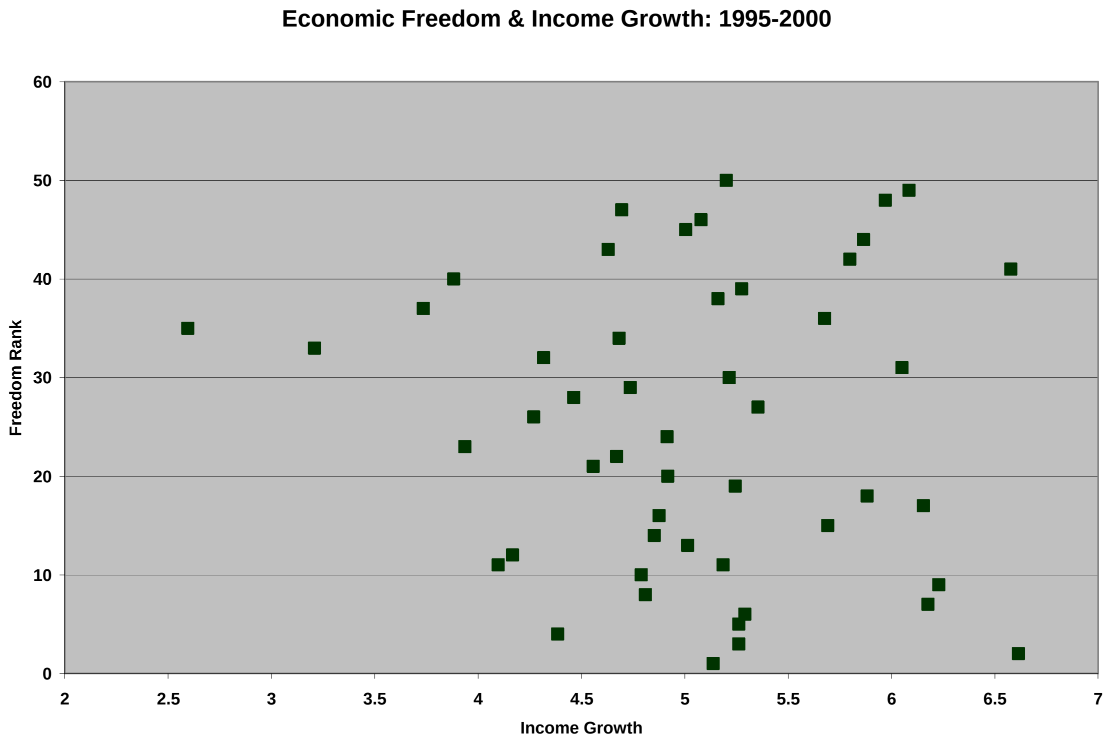
My June **Economic Situation** report has a serious error in the discussion of state economic freedom, and I want to get it right. The error, called to my attention by economist Jerry Ellig at George Mason University’s Mercatus Center, is seen in the next chart, which I reproduce from last week’s report.

The chart shows a mapping of the fiscal component of the 1999 state economic freedom index and 2000 state per capita income. The chart and trend line show state per capita income rising with larger numbers on the horizontal axis. The problem comes with the fact that larger numbers relate to lower fiscal freedom, not higher. The clue is seen in the observation for Connecticut, a higher income/heavy tax state.



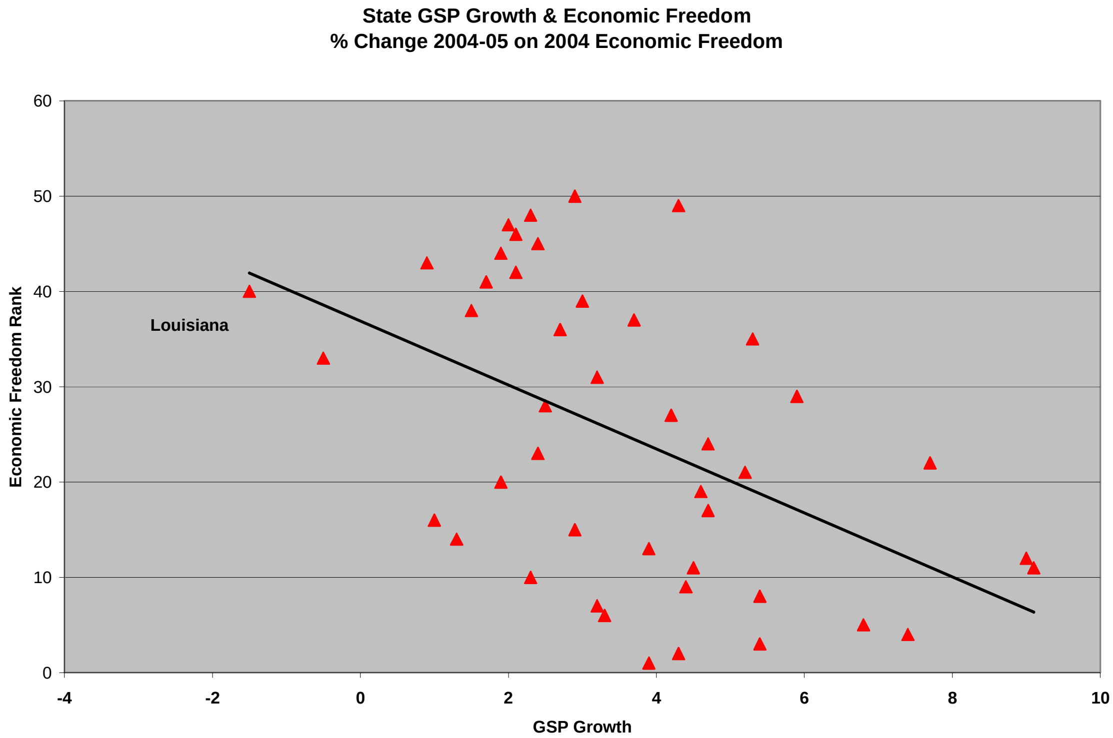
I have worked with this data enough to know that higher income states more often than not are the more mature states where tax burdens are highest. But this one slipped by.

In drilling deeper into the matter, I reasoned that income growth mapped against the full index of economic freedom might give a different picture. The next chart shows the result of that data expedition. Remember, larger freedom rankings are for lower freedom. The data points in the chart are close to being randomly distributed.



I then reasoned that income and income growth are quite different from state product and growth in state product. Income can arise from wealth, old and new, from retirement savings, and transfers. Product comes from production activities. Freedom provides the opportunity to build enterprises and produce new goods and services. Heavier taxes discourage population growth. Higher freedom attracts people and production.

I decided to map growth in state production, gross state product (GSP), into economic freedom. To get the most recent margin of action, I mapped the percentage change in GSP for 2004-2005 into the 2004 state economic freedom rankings developed by Pacific Institute. The next chart gives the result. Here we see higher GSP growth associated with higher economic freedom, which is related to smaller values for the economic freedom index. I note that Louisiana had negative GSP growth for the period.

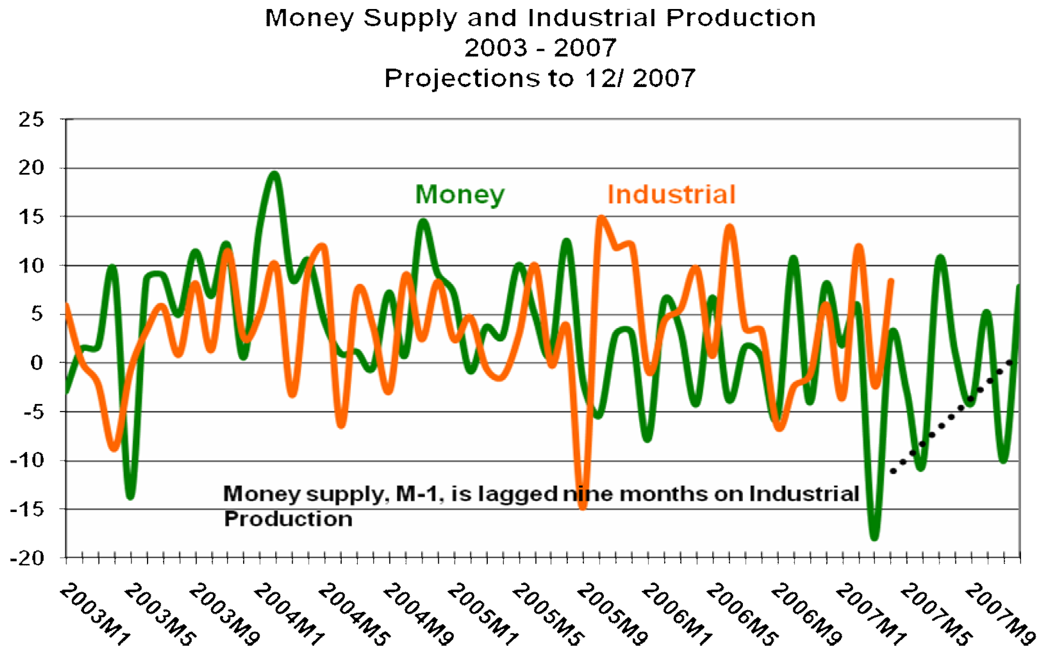


New data on Industrial Production.

While providing a correction for one part of the June report, let me give an interesting update on another part. Data for April Industrial Production growth arrived a few days ago. I have added that and other recent observations to the chart that shows the relationship between money supply growth and industrial production.

I provide an updated chart that includes extended observations for money supply growth. Recall that industrial production lags money supply growth by nine months.

So far, money is calling the tune.



Frank H. Neely and cool serendipity at Rich's.

In her delightful book *Dear Store*, Celestine Sibley recounts the history of that great Atlanta institution, Rich's department store. The store's 1867 origin misses the birth of Atlanta by just 20 years. It all began when Morris Rich, an immigrant from Kaschau, Hungary, started a small one-room retail store on Whitehall Street just four years after General Sherman's burned his way through Atlanta. As more Rich brothers came to join their brother, Rich's changed to Rich's and Bro and then to Rich's and Bros. Needless to say, Rich's prospered.

Major growth and gains in efficiency came in 1924 when Rich's put engineer Frank H. Neely in charge of operations. While Neely led the firm successfully for decades, he added features to retailing that revealed his engineering roots.

Rich's was the first large store in America to become fully air conditioned. Since this had not been done before, no one knew if it would work. But Neely had successfully chilled a candy production line for another Atlanta firm prior to joining Rich's. Working with York Air Conditioning, in 1926 Rich's took the plunge, doing so without fanfare for fear the whole idea would turn out to be a bad call.

The big day came. The windows were closed. Rich's was cooled even while thousands came and went through the large doors. The customers loved it, and the corsets and linens did not have been dusted to remove the soot from the many trains that passed through Atlanta.

What worked for candy worked for Rich's…, and eventually everyone else.

A cool story.