CAN THE GOVERNMENT RUN THE ECONOMY?

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Is our economy a machine, like an automobile, a train or a power plant?

One constantly hears phrases such as the economy "is overheating" or "needs to cool off" or "could use some stimulus." These aren't harmless metaphors. They epitomize how economists have taught us to see an economy—as something that can be manipulated, guided or driven. And guess who does the driving? The government.

The government is supposed to make sure that the economy "hums" along at an even speed, going neither too fast nor too slow. But the economy is not a machine. It is made up of people, and no one can control what billions of them are going to do.

What gets overlooked, underplayed or simply ignored is the extraordinary "churn" in the activities of a free market. New businesses open while others close, constantly. In the U.S. during normal times a half-million or more jobs are created each week, while another half-million are cut. Entrepreneurs continually roll out new products and services, most of which flop. But those that succeed can greatly improve our quality of life.

What government can and should do is to positively influence the environment in which this hum of activity takes place through sensible taxation, monetary policy, government spending and regulation. And in almost all instances the best prescription for economic health is "less is more."

Catastrophic mistakes by governments can poison the marketplace, as happened during the Great Depression in the 1930s, to a lesser extent in the 1970s, and then again in the panic of 2008–09.

The government's recent mistakes have been compounded by tax increases and an avalanche of antigrowth regulations from ObamaCare, the Dodd-Frank financial services bill and all those Washington regulatory agencies, such as the FCC, the EPA and the National Labor Relations Board. If you want to understand why the American economy has been growing at the anemic pace of 1 to 2 percent a year, look no further.

Again, the idea of an economy that purrs along like a well-oiled machine hurts, not enhances, wealth creation because invariably, it leads to growth retarding government intervention. Which brings us to bubbles.

Shouldn't the government, the argument goes, at least try to stop them from happening? Well, it depends. Those caused by misguided government policies like the housing bubble

of the mid 2000's, yes. Those caused by the free market, no. Bubbles have a bad name, but not all of them are created equal. There are healthy ones and unhealthy ones. The good kind develops when a lot of people simultaneously recognize a great opportunity.

Computers are an excellent example. During the early 1980s there was a boom in personal computers–followed by a severe shakeout, when companies such as Atari and Commodore bit the dust.

In the late 1990s a number of companies recognized the importance of search engines. Google emerged supreme with Microsoft and others relegated to fractional market shares.

More recently mobile phones went through its own shakeout with a dozen different brands competing for market share. Once Nokia was king. But now the Apple iPhone and Samsung dominate.

Good bubbles are a sign of a vibrant and innovative economy. The excesses are ultimately squeezed out, and capital is redeployed to more promising opportunities. But bubbles artificially caused by government policies–such as the housing bubble–are disastrous. The housing crisis was largely created by government policies, including pushing banks into giving mortgages to people who could not really afford them. When large numbers of those borrowers stopped making their payments, the market crashed and everyone got hurt by unnecessary government meddling.

Finally, there are business cycles. Shouldn't the government smooth those out? Economists have puzzled over business cycles–the ups and downs of an economy–for more than 200 years. Most have treated the phenomenon like an illness, something to be cured, instead of what it is: the ebb and flow of the free market, where what people might want is created and what people don't want is destroyed. Trying to arrest this free market process of creative destruction, as it is known, inevitably leads to stagnation—that is, little or no economic growth. For current examples see Japan and most of Europe.

Here's a rule: the more a government tightens its grip, the less an economy grows. That's because an economy is not a machine and the government can't force it to act like one.

So, let's free the free market. That is and always has been the surest path to prosperity.

I'm Steve Forbes for Prager University.