

The Free Market

September 1985 • The Ludwig von Mises Institute

Human Inaction: Congress and Economics

by Congressman Dick Armey

It is well-known that bureaucracies, especially governmental bureaucracies, have an unparalleled ability to suffocate innovation. Perhaps not as well known is the ability of those same institutions to ignore systematically well-documented, empirically supportable precepts about how the world really works.

Congress is the archetypical example of this black hole of historical precedent. It is an institution with an uncanny inability to distinguish between good and bad ideas, and almost invariably enact the bad. The bad ideas are defended with rhetorical barrages untainted by any understanding of the human action of free exchange based on free will.

Much to my chagrin—as a wayward economist who found his way to this body—no subject is so paved with good intentions . . . and bad government policy. To most members of the House, “Austrian” means only a good place for summer ski vacations.

For example, here are five of the worst economic ideas currently being circulated, debated, and advocated with scrupulous disregard for fact on Capitol Hill.

Comparable Worth—This brainchild of social engineers inspired U.S. Civil Rights Commissioner Clarence Pendleton to label it “the looniest idea since Loony Tunes.” Basically it amounts to government-mandated wages. In the name of equality, this concept ignores the fact that women make less than men because *on average* they tend to have less experience, choose to work fewer hours, choose to leave jobs to raise families, and sometimes—for family reasons—choose lower skilled (and hence lower-paying) jobs. In disregard of all these choices and all market analysis and behavior, the government planners advocate establishing a wage and salary board with the authority to set “fair” wages based on arbitrary and discriminatory guidelines.

Level Playing Field—This used to be known as protectionism, but in the modern lexicon of Washington, it’s referred to as “fair trade.” Congress, of course, rushes to the aid of firms; consumers are rejecting with bail-outs, tariffs, quo-

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Ambassador J. William Middendorf, II, (left) is introduced by Institute Senior Fellow Steve H. Hanke (right) of Johns Hopkins University.

Mises Institute Inaugurates D.C. Seminars

The Mises Institute began its Washington, D.C., seminar series with three outstanding presentations.

Dr. Murray N. Rothbard, professor of economics at New York Polytechnic and the Institute’s vice president for academic affairs, discussed “Ludwig von Mises and Austrian Economics”; the Hon. J. William Middendorf, II, then U.S. Ambassador to the Organization of American States (now to the European Community) and chairman of the Institute’s advisory council of public officials, talked on “The Future of Latin America: Free Market or Decline”; and Dr. Richard Ebeling of the University of Dallas, an adjunct scholar of the Institute, gave a presentation on “An Austrian View of Spending and Deficits.”

Guests at the seminars include government officials,
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Coming Events

“Bankruns and Water Shortages”

LETTERS

From a student in Texas

"In the short time I have been involved in economics, it has become increasingly clear to me that the field is in chaos.

"During the 20th century, the majority of economists have claimed that through statistical analysis, they can straighten out the business cycle, insure full employment and competition, stabilize prices with full economic growth, and maintain a just distribution of wealth.

"The consequences of these ideas have been disastrous. The Keynesians add more complex variables to their models, as do the econometricians, but this doesn't work either.

"Now it is possible to justify any new harebrained political scheme by citing some economist who can 'prove' that the new intervention will benefit everyone. As a result, the whole field of economics is at a crossroads.

"But, amidst all the economic nihilism, there stands a school of thought—although still a minority one—that recognizes that no matter how the state attempts to manipulate people as pawns, there is still only one way for society to achieve its highest end: through the spontaneous order of freedom.

"Hayek's famous dictum summarizes it well: the good society is a result of human action, not human design.

"Following the intellectual tradition of Austrian economics, from Carl Menger and Ludwig von Mises through Murray Rothbard and Hans Sennholz, has been a most rewarding challenge to me over the last two and a half years.

"I was introduced to Austrian economics and the free market after two semesters of strict Keynesianism. In knowledge and understanding of Austrian economics I am, of course, only a beginner. I will continue to read and study the staple texts again and again, and read other works as well. I want to spend my career studying, teaching, and promoting the ideas of the Austrian perspective, and hope to contribute someday myself to scholarly research in this area.

"I will be pursuing my Masters and then my PhD in economics at the University of Houston, and a Mises Fellowship would help me reach my goals. I would consider it a great honor to be associated with the Institute, and will do my absolute best to promote the ideas embodied in this great intellectual tradition." ■

The Institute was very glad to be able—through the generosity of its Members—to help this fine student.

From the President The \$2 Trillion Debt

by Llewellyn H. Rockwell, Jr.

The Treasury will ask Congress this month for an increase in the national debt ceiling to \$2 trillion—more than double the amount Jimmy Carter left us.

The debt-ceiling is always the figure to watch instead of the budget deficit, because the official figures don't include off-budget deficits. Thus, although this year's federal deficit is said to be \$200 billion, it's actually more than \$250 billion.

Financing the debt requires federal spending of more than \$150 billion a year, and because the debt is virtually all short-term—the Federal Reserve having destroyed the long-term bond market—the financing costs rise quickly with higher inflation and interest rates.

Who's to blame for these unimaginable figures? The politicians, who propose and pass massively out-of-balance budgets, and the intellectuals who excuse them.

The culprit is not tax-cutting. Today's government revenues are more than \$100 billion higher than they were in 1980, but federal spending is more than \$300 billion higher. If the surplus of government spending over taxes is borrowed, it makes productive private borrowing much harder, and many projects which would have provided jobs and a higher standard of living for everyone are never undertaken. Government borrowing also drains society's savings in a particularly direct and damaging way.

If federal deficits are financed through Federal Reserve creation of bank credit, the dollar is depreciated, with all of the economic suffering and societal instability inflation brings. And today, that is the way more and more of the deficit is being financed. That's why non-seasonally adjusted M1 rose a mind-boggling \$17.9 billion one week in August.

Will higher taxes help? No, because the politicians will always spend every dime they extract in taxes, and more, and a giant percentage of society's resources is already wasted by government.

In the short term, we can only work for lower federal spending in every area of the budget. In the long term, we can work for a gold standard.

A real gold standard makes inflationary credit creation impossible. Combine that with a constitutional prohibition against unbalanced budgets (and against off-budget financing), and a people watchful against high government spending and taxes, and we have the kind of system the Founders envisioned. Go on as we are—in monetary, fiscal, and trade policy—and we face another Great Depression.

Bank Runs and Water Shortages

by Murray N. Rothbard

It was a scene familiar to any nostalgia buff: all-night lines waiting for the banks (first in Ohio, then in Maryland) to open; pompous but mendacious assurances by the bankers that all is well and that the people should go home; a stubborn insistence by depositors to get their money out; and the consequent closing of the banks by government, while at the same time the banks were permitted to stay in existence and collect the debts due them by their borrowers.

In other words, instead of government protecting private property and enforcing voluntary contracts, it deliberately violated the property of the depositors by barring them from retrieving their own money from the banks.

All this was, of course, a replay of the early 1930s: the last era of massive runs on the banks. On the surface the weakness was the fact that the failed banks were insured by private or state deposit insurance agencies, whereas the banks that easily withstood the storm were insured by the federal government (FDIC for commercial banks; FSLIC for savings and loan banks).

But why? What is the magic elixir possessed by the federal government that neither private firms nor states can muster? The defenders of the private insurance agencies noted that they were technically in better financial shape than FSLIC or FDIC, since they had greater reserves per deposit dollar insured. How is it that private firms, so far superior to government in all other operations, should be so defective in this one area? Is there something unique about money that requires federal control?

The answer to this puzzle lies in the anguished statements of the savings and loan banks in Ohio and in Maryland, after the first of their number went under because of spectacularly unsound loans. "What a pity," they in effect complained, "that the failure of this one unsound bank should drag the sound banks down with them!"

But in *what* sense is a bank "sound" when one whisper of doom, one faltering of public confidence, should quickly bring the bank down? In what other industry does a mere rumor or frisson of doubt swiftly bring down a mighty and seemingly solid firm? What is there about banking that public confidence should play such a decisive and overwhelmingly important role?

The answer lies in the nature of our banking system, in the fact that both commercial banks and thrift banks (mutual savings and savings-and-loan) have been systematically engaging in fractional-reserve banking: that is, they have far less cash on hand than there are demand claims to cash outstanding. For commercial banks, the reserve fraction is now about 10 percent; for the thrifts it is far less.



Murray Rothbard (left) and Lew Rockwell (center) with David Fand (right) of Wayne State University, the Heritage Foundation's John M. Olin Fellow, at an Institute seminar in Washington.

This means that the depositor who thinks he has \$10,000 in a bank is misled; in a proportionate sense, there is only, say, \$1,000 or less there. And yet, both the checking depositor and the savings depositor *thinks* that he can withdraw his money at any time on demand. Obviously, such a system, which is considered fraud when practiced by other businesses, rests on a confidence trick: that is, it can only work so long as the bulk of depositors do not catch on to the scam and try to get their money out. The confidence is essential, and also misguided. That is why once the public catches on, and bank runs begin, they are irresistible and cannot be stopped.

We now see why private enterprise works so badly in the deposit insurance business. For private enterprise only works in a business that is legitimate and useful, where needs are being fulfilled. It is impossible to "insure" a firm, even less so an industry, that is inherently insolvent. Fractional reserve banks, being inherently insolvent, are uninsurable.

What, then, is the magic potion of the federal government? Why does everyone trust the FDIC and FSLIC even though their reserve ratios are lower than private agencies, and though they too have only a very small fraction of total insured deposits in cash to stem any bank run? The answer is really quite simple: because everyone realizes, and realizes correctly, that only the federal government—and not the states or private firms—can print legal tender dollars. Everyone knows that, in case of a bank run, the U.S. Treasury would simply order the Fed to print enough cash to bail out any depositors who want it. The Fed has the unlimited power to print dollars, and it is this unlimited power to inflate that stands behind the current fractional-

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Rothbard . . . continued from page 3.
reserve banking system.

Yes, the FDIC and FSLIC "work," but only because the limited monopoly power to print money can "work" to bail out any firm or person on earth. For it was precisely bank runs, as severe as they were that, before 1933, kept the banking system under check, and prevented any substantial amount of inflation.

But now bank runs—at least for the overwhelming majority of banks under federal deposits insurance—are over, and we have been paying and will continue to pay the horrendous price of saving the banks: chronic and unlimited inflation.

Putting an end to inflation requires not only the abolition of the Fed but also the abolition of the FDIC and FSLIC. At long last, banks would be treated like any firm in any other industry. In short, if they can't meet their contractual obligations they will be required to go under and liquidate. It would be instructive to see how many banks would survive if the massive governmental props were finally taken away.

* * * * *

Water Not Running

Most people agree that government is generally less efficient than private enterprise, but it is little realized that the difference goes far beyond efficiency. For one thing, there is a crucial difference in attitude toward the consumer. Private business firms are constantly courting the consumer, always eager to increase the sales of their products. So insistent is that courtship that business advertising is often criticized by liberal aesthetes and intellectuals as strident and unmannerly.

But government, unlike private enterprise, is not in the business of seeking profits or trying to avoid losses. Far from eager to court the consumer, government officials invariably regard consumers as an annoying intrusion and as "wasteful" users of "their" (government's) scarce resources. Governments are invariably at war with their consumers.

This contempt and hostility toward consumers reaches its apogee in socialist states, where government's power is at its maximum. But a similar attitude appears in areas of government activity in all countries. Until a few decades ago, for example, water supplies to consumers in the United States were furnished by private companies. These were almost all socialized, so that government has come to monopolize water services.

In New York City, which shifted to a monopoly of

government water several decades ago, there was never, in previous decades, any wailing about a "water shortage." But, recently, in a climate that is not conspicuously dry, a water shortage has reappeared every few years. This July water levels in the reservoirs supplying New York City were down to an unprecedented 55 percent of capacity, in contrast to the normal 94 percent. But surely, nature is not solely to blame, since neighboring New Jersey's water levels are still at a respectable 80 percent. It seems that the New York water bureaucrats must have carefully sought out nearby spots that particularly suffer from chronic drought. It also turns out that the New York pipelines were constructed too narrowly to increase water flow from wetter regions.

More important is New York's typical bureaucratic response to this, as well as to other periodic water crises. Water, as usual with government, is priced in an economically irrational manner. Apartment buildings, for example, pay a fixed water fee per apartment to the government. Since tenants pay nothing for water, they have no incentive to use it economically; and since landlords pay a fixed fee, regardless of use, they too couldn't care less.

Whereas private firms try to price their goods or services to achieve the highest profit—i.e. to supply consumer needs most fully and at least cost—government has no incentive to price for highest profit or to keep down costs. Quite the contrary. Government's incentive is to subsidize favored pressure groups or voting blocs; for government is pressured by its basic situation to price politically rather than economically.

Since government services are almost never priced so as to clear the market, i.e. equate supply and demand, it tends

Upcoming Events

September 7th: Vero Beach, Florida. Ron Paul discusses "Mises and Austrian Economics: A Personal View" and Dr. Bill Dunn is presented with the Institute's highest award.

October 5th: St. Louis, Missouri. A joint seminar with the Discussion Club on "Deficits and Debts: Do They Matter?" With Dr. Ron Paul, Dr. Murray N. Rothbard, and Dr. Steve H. Hanke.

October 19th: Los Angeles, California. "What Has Government Done to Our Money?"—a seminar with Mr. John Pugsley, Dr. Murray Rothbard, Dr. Mark Skousen, and Dr. Joseph Peden—followed by a gala dinner and reception in honor of Howard Ruff.

For more information, phone 202-543-7696.

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tas, and various trade barriers to protect us from those added "cheap imports." A few jobs and firms in the protected industry are saved, while in the meantime prices rise, quality drops, other countries retaliate, and U.S. export firms that would otherwise prosper lose jobs or go out of business.

Civil Rights Restoration—A monumentally bad economic idea clothed in the hide of a legislative sheep, HR 700 was resurrected this year. This bill pretends to be a civil rights act, but in reality would extend federal control in virtually every area of business, education and religion in America. This amounts to no more than "buzz-word blackmail" coercing House Members to vote for more economic control.

Minimum Corporate Tax—This is the classic paradox of modern statism: high tax rates that limit growth and productivity, a plethora of deductions to correct for confiscatory rates, and the ultimate irony of a minimum tax for those who either by lack of profits or use of legal deductions, reduce their tax burden to below an "acceptable level." This represents my favorite example of a corrupt government practice. In fact, only people pay taxes and corporate taxation is "government by disguise," hiding the cost of government from the buyer as a subtle way to convince us to take more government than we need or want.

Farmers and Ethiopians—The Congress has been very busy this session appropriating hundreds of millions of dollars to American farmers to bail them out of an agriwelfare-induced recession. Meanwhile, millions more went to Ethiopia where the spectres of Marx and Lenin oversee yet another central-planning debacle. Some House Members have even held hands and sang songs with each other, but to no avail. Somehow, subsidies and socialism always have the same results as they have for centuries: distorted markets, decreased productivity, waste, and deprivation.

These are just a few waves in the veritable sea of bad ideas on which Congress is currently adrift. Help is on the way, however. A small band of counter-revolutionaries is speaking the name of Mises and espousing the miracle of the market. Perhaps Armey's Axiom 1 (the market's rational; the government's dumb) will never be codified into law, but the American people understand, and with their prodding—and the educational help of the Mises Institute—Congress may get the message. ■



Dr. Dick Armey, U.S. Congressman from Texas, was formerly chairman of the economics department at North Texas State University. He is a distinguished adjunct scholar of the Mises Institute, and a member of its advisory council of public officials.

Mises Institute Hosts Council for Monetary Reform

Congress has passed a bill to issue one dollar silver coins weighing one ounce. And one-ounce, half-ounce, quarter-ounce, and tenth-ounce gold coins may be authorized as well.

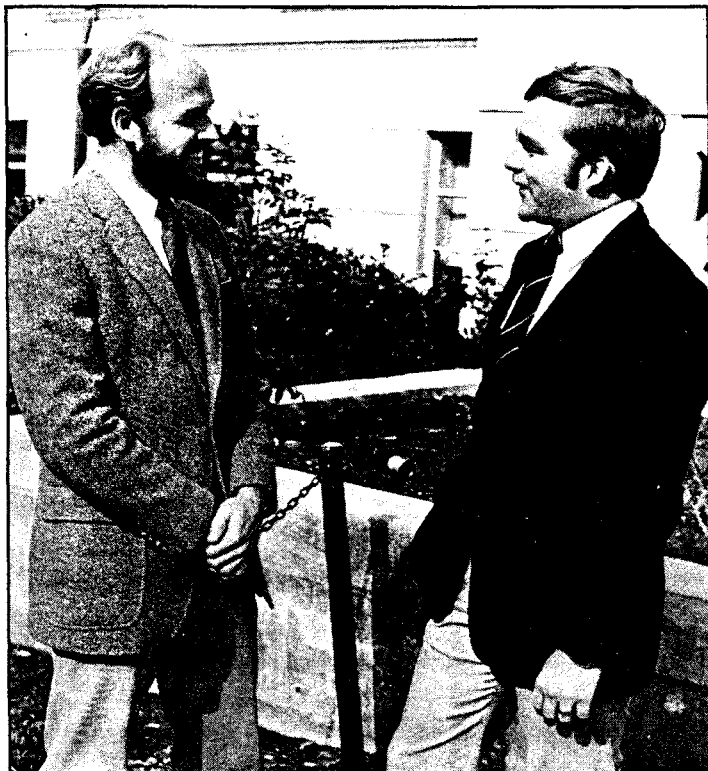
The Council for Monetary Reform recently met in the Mises Institute's Washington, D.C., conference room to consider the economic implications of these changes. In the Council's view, these bills offer Americans the chance to hold money less shaky than today's fiat dollars and they "may even offer possibilities for development of an alternative or parallel monetary system for the United States." Recent banking crises, especially in Ohio and Maryland, have drawn attention to the instability of the existing system based on Federal Reserve discretion.

Members also discussed the abolition of central banking and the institution of a sound monetary system, and a working paper submitted by one of its members, Professor Roger Garrison, the Mises Institute's Auburn academic advisor, advocating a gold standard. (Copies are available from the Institute.)

The Council for Monetary Reform, an organization of professional economists and heads of economic research institutes, meets three times a year in Washington, D.C., to analyze and propose reforms in the present unstable monetary system. It is chaired by former Congressman Ron Paul, a member of the Institute's board and senior counsellor; its secretary is Institute president Lew Rockwell; its executive director is Joe Cobb, chief monetary economist for the Joint Economic Committee of Congress.

Members present at the meeting—in addition to Ron Paul, Lew Rockwell, and Joe Cobb—included Richard Ebeling of the University of Dallas; William Quirk of the University of South Carolina; Murray N. Rothbard of the





John McCallie (left) and Sven Thommesen (right), William A. Dunn Fellows of the Mises Institute at Auburn University for the 1985-86 academic year.

Ludwig von Mises Institute; Joseph Salerno of Rutgers University; Hans F. Sennholz of Grove City College; David Theroux of the Pacific Institute; and Leland Yeager of Auburn University. ■

Letters ... continued from page 2.

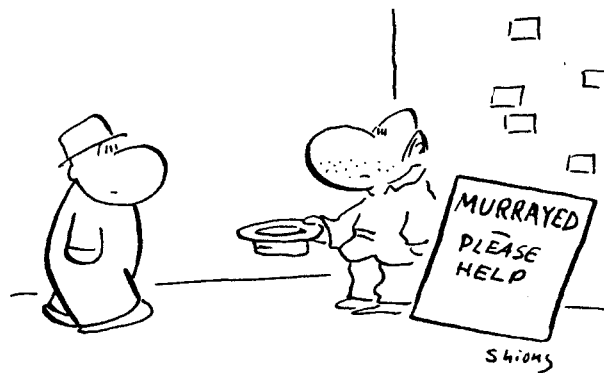
From a student in Poland

"I am very grateful to the Ludwig von Mises Institute for the valuable books you sent me. Reading the great works of Mises and Rothbard has been an extraordinary experience for me. It has been a turning point in my way of thinking of economic, political, and social issues. . . .

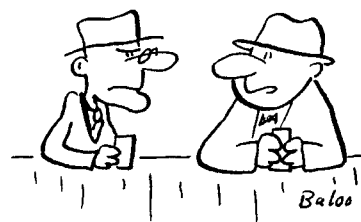
"I would like to contribute to the development of the Mises Institute, but my hard-currency resources are extremely limited. In the future, I will contribute my share. . . .

"I will start my research work at Jagiellonian University in Cracow in Autumn 1985. Thank you so much for the materials you send me every month."

The Institute is very glad to be able to help a select group of economics students behind the Iron Curtain. The program is, of course, highly confidential, with the books being routed through another country.



CY 962



"I can see how it might eliminate the deficit, but how would you get Washington DC to secede?"

CY 507

Seminars . . . continued from page 1.

Congressional and think-tank staffers, faculty, students, and Institute Members. Future programs include Dr. Ron Paul on "Why the Federal Reserve Should Be Abolished"; Mr. Lewis E. Lehrman on "The Moral Case for the Gold Standard"; Congressman Philip M. Crane on "The Historical Case for the Gold Standard"; and Congressman Richard Armey on "An Austrian Economist Looks at Congress." ■

The New York Times, August 8, 1985

Put New York's Water Supply in Private Hands

To the Editor:

Your editorial "Too Dry, Too Late" (July 23) bemoans the fact that Mayor Koch has not moved more rapidly and forcefully to promote the water-conservation ethic in New York City. This, you say, would induce consumers to install flow reducers in shower heads, reduce toilet-tank capacity and initiate in-house leak detection and waste-control measures. Such conservation, you conclude, is the only answer to the drought. This counsel, while well intended, is analogous to sending a big-game hunter off on safari armed with an air rifle.

Water conservation and waste reduction in New York City should be focused on the city's water-supply system. Because of maintenance and replacement policies, much of the system is falling apart. In consequence, leakage represents the city's largest "water user," with about 10 to 20 percent of the water that enters the system wasting away through leaks. (It is impossible to make a precise determination of system leakage—total water production minus metered use—in New York because the city is not universally metered).

A review of post-World War II re-

ports on the city's water-supply situation reveals that each recognized and highlighted the system's serious physical problems and consequent waste. For example, the engineering panel on water supply chaired by Thorndike Saville devoted an entire chapter in its 1961 report, "Future Water Sources of the City of New York," to waste reduction. Professor Saville and his colleagues concluded that "underground leakage in the New York distribution system is larger than it should be," and "waste restriction would appear to be the cheapest method of providing additional available water for New York City." As we know, the city has failed to act on this or subsequent system-waste recommendations. In consequence, the annual number of main breaks per mile of main has increased more than 60 percent in the last 30 years.

Public enterprise has not been up to the task of managing and conserving New York's scarce water resources. The solution of the city's water problem is simply too important to be left in the hands of politicians and public officials. Decisive action and responsible management are required. Private ownership is the only answer.

Knowing New York City's provincial attitudes, we can anticipate its response to this proposal: "Yes, this is a fine theoretical idea, but New York City is different. Our system is too old, complex and large for private enterprise to own and operate."

Allow me to suggest that the city examine the private water system in Paris. The first private connections in Paris were installed by the Perrier brothers in 1782. Since then, the Parisian system has evolved into one of the world's largest, most sophisticated, cost-effective waterworks systems. The success of the Parisian system can be laid squarely at the feet of private ownership and regulation through competition, rather than public regulatory bodies.

STEVE H. HANKE
Professor of Applied Economics
The Johns Hopkins University
Baltimore, July 25, 1985

The writer is associate editor of Water Resources Research and The Water Resources Bulletin. During 1981-82 he was a senior economist on the Council of Economic Advisors. He is also senior fellow with the Ludwig von Mises Institute.

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Ron Paul Scholarships Available

Ron Paul Fellowships of \$1,000 apiece are available from the Mises Institute for undergraduate study. The grants are named in honor of former Congressman Ron Paul, the Institute's senior counsellor and member of its board, and an outstanding exponent of Austrian economics and the free market. Students—from high school seniors through juniors in college—wishing to apply must:

- 1) Be admitted to, or be a student in good standing at, an accredited college or university;
- 2) Show evidence of outstanding academic performance;
- 3) Have financial need;
- 4) Be, or intend to be, an economics major;
- 5) Have demonstrated a strong commitment to the free market and Austrian economics, especially the work of Ludwig von Mises.

Applications addressing all five points, and including the last grade transcript and two letters of recommendation (one of which must be from a teacher or professor), should be sent to the Mises Institute, Auburn University, Auburn, Alabama 36849, attention: Ron Paul Scholarships.

Note: these fellowships were established through the generosity of Institute Members. Additional tax-deductible contributions to the Mises Institute's Ron Paul Fellowship Fund are most welcome. ■

Your Company Can Double Your Gift

If your employer has a matching-gift program, you can double (or even triple) your next tax-deductible contribution to the Mises Institute at no additional cost. In general, there are two types of matching-gift programs:

ONE recognizes only colleges and universities. In this case, please make your next contribution payable to the Auburn University Foundation for use by the Mises Institute, and send the check and matching-gift form to the Mises Institute, Auburn University, Auburn, Alabama 36849.

TWO recognizes all educational and charitable organizations that are tax exempt under Section 501(c)3 of the IRS code. In this case, please make your contribution payable to the Mises Institute, and as above, send your check and matching-gift form to our Auburn office.

The work of the Mises Institute has been helped significantly by thousands of dollars in matching gifts. We would be honored to have yours as well. ■

Publication of the Month

The Gold Standard

An Austrian Perspective

Llewellyn H. Rockwell, Jr.

The first major Mises Institute conference took place in Washington, D.C., on the gold standard from an Austrian perspective. Now scholarly Lexington Books has published the important papers delivered there in book form.

The book includes essays by Murray N. Rothbard; Hans F. Sennholz; Richard M. Ebeling; Roger W. Garrison; Joseph T. Salerno; Lawrence H. White; and Ron Paul. It was edited by Institute president Lew Rockwell, who directed the conference, and includes an introduction by Leland B. Yeager.

The retail price, plus postage and handling, of this hardbound volume is \$30.25. Members' price is \$24.65. If you would like a copy of this landmark volume, which would also make an appropriate gift for school and college libraries, just write "Gold" in the upper right-hand corner of the enclosed reply form, and enclose your check for \$24.65 plus any tax-deductible contribution for the Institute's work for the gold standard. ■

Deferred Giving

At the request of Members, the Ludwig von Mises Institute has established a deferred-giving program. Remembering the Institute in your Will, for example, continues the fight for freedom down through the years.

There are also trusts that combine significant tax benefits with substantial help for the Institute.

For more information, please write:

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