

FREEMarket

PUBLISHED 11 TIMES PER YEAR BY THE LUDWIG VON MISES INSTITUTE

MONEY AND OUR FUTURE

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We are fortunate to be living in these times, for we are seeing the unfolding of events long explained and predicted by the Austrian tradition. Maybe that sounds implausible. What is fortunate about our times? The economy is tanking, stocks have been pummeled, unemployment is rising, and Washington is pursuing the worst combination of economic policies since Hoover and FDR. Nor does the new guy in charge seem to have a clue about the limits of what government can do.

Consider what it means to live through our times in the light of economic understanding. Even in the face of calamity, there is no mystery, and hence fear is reduced.

You look at department stores going belly-up, and you know why. You see parking lots empty, and you know the reason. You have friends losing their jobs, and there is clarity concerning the cause. You see depositors in failing banks lose their money, and you are not surprised. Prices behave in ways that shock and surprise everyone else, but you know what's what.

In many ways, it is like watching the movement of stars and planets with the scientific knowledge provided by astronomy—or observing the effects of a plague with medical knowledge.

Without the understanding, the events look mysterious, like a curse from the gods, and their patterns appear random. With the knowledge, with the understanding, we can make sense of the events. Patterns of cause and effect emerge. You see events before they happen, like turning the page of a script before the movie catches up to you. This gives you a sense of intellectual coherence and inner peace—even in the midst of calamity.

If you read what Mises wrote during the Great Depression and World War II, you can see firmness of conviction and steadfast calm, even as the whole world was going nuts. Intellectual clarity is the key to seeing the right things and doing the right things. It is a matter of knowing the shape of things even before the things take shape.

Knowledge provides a means of curing the ill. It provides a way out, an answer that gives hope. This is a major reason why people with an Austrian understanding in the midst of financial meltdown keep their wits about them.

Yes, it is more than frustrating to see people in Washington spending trillions in a futile effort to repeal economic law. It is sheer madness that they are creating vast ➡



quantities of new dollars by means of the Fed's power, even with evidence from the whole of human history that new money only waters down the value of the old, and does nothing to provide a long-term boost to the economy, and much to further distort economic structures.

It's like watching as barbers bleed patients in the name of curing them, or bringing in the witch doctors to cast out demons from people with the flu. But even if our knowledge of events cannot stop what these people are doing for now, it provides us with a sense of solace in the face of disaster. We can keep our heads, even as others run around as if theirs had been cut off.

In order to understand events, there is no substitute for doing what the media and most economists refuse to do, which is to look at the big picture and the long view, over decades. It is a matter of applying the rule that Henry Hazlitt brings home so clearly in *Economics in One Lesson*: economics consists in looking at the effects of policies not on one group but on all groups, not only in the short run but also in the long run.

From the long-run point of view, we observe an intriguing illustration of the Austrian warning against ever attempting to bail out an economy that is pushing toward recession. In 2001, the economy wanted to go into recession but the government wouldn't let it happen. It was the first stimulus package in the new millennium, consisting of vast new funding and vast money creation, with the Fed driving down rates and keeping them rock bottom.

If you look at the short run, it seems that it worked. But looking at the long run, we can see that the attempt to forestall

recession only ended up creating a bigger disaster down the line.

Something very similar happened in the short recession of 1991. Clinton came to power and shortened the recession, which only created another bubble in financials that broke and so on, until we are where we are today.

Arguably the last time that a recession was permitted to run its course was following the crack-up boom in the end of the Carter years, as a result of Nixon's inflation. Reagan came to power, with Carter's choice of Volcker at the Fed. Reagan ignored the crying from Congress and the press. He let interest rates rise; the federal-funds rate was 20 percent and prime was at 21.5 percent in 1982. Unemployment reached nearly 11 percent. Inflation fell from 13.5 percent in 1980 to 3.2 percent in 1983.

If we include the S&L debacle in this, it was a nearly total blowout, and if Reagan had left it at that, it would have been a model for how to deal with recessions. There is pain and suffering. But wait it out and you have a fertile ground on which to build a solid prosperity. Sadly, you also produce a solid financial footing that invites the government to abuse the system, as Reagan did with record spending and deficits.

If we want to look back even further to find better examples of how to handle recession, we can look at 1920 and 1921. The less the government did, the better the results long term. Murray Rothbard's own dissertation on the Panic of 1819 is an interesting case. He took a look at a pure case in which nothing was done to fix a problem. The problem went away. What was notable about this panic is precisely

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Jeffrey M. Herbener, Robert Higgs, Mark Thornton.
Publisher: Llewellyn H. Rockwell, Jr.

The *Free Market* is published 11 times a year.

Note: the views expressed in the *Free Market* are not necessarily those of the Ludwig von Mises Institute.

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that it never made the history books. It didn't because the government didn't make it worse.

In the months ahead, we are going to witness more of these ridiculously futile attempts to patch up a failing economy, and we are going to pay a big price this time. It won't be like 2001 or 1992. We will be lucky if it ends up like 1978–1982. More likely, it is going to be worse—and how much worse depends on just how stupid the Obama administration is going to be. It is hard to imagine that these people will be worse than Bush, but it could happen.

We all must deal with the possible death of the dollar. Many plans have been proposed through the years that would restore the gold dollar, and many have merit. They all provide a means to go back to gold. While they are not lacking in technical detail, they are lacking in something that they can't provide: the political will to do the right thing. They are all premised on the idea that our leaders might be interested in doing the right thing. But the same people that would be in charge of implementing the reform are the very ones who got us into this mess.

It is hard enough in the course of regular life to get anyone to admit an error and reverse course. In politics, it virtually never happens. Even in the case of egregiously immoral effects, the political class persists in error, mainly because it is more interested in saving itself than saving society. Guido Hülsmann points out in his new book, *The Ethics of Money Production*, that “governments inflate the money supply because they gain revenue from inflation.”

This is hardly a new insight. Hülsmann quotes the 14th-century Bishop Nicholas Oresme as follows:

“I am of the opinion that the main and final cause of why the prince pretends the power of altering the coinage is that profit or gain which he can get from it; it would otherwise be vain to make so many and so great changes. . . . Besides, the amount of the prince's profit is necessarily that of the community's loss.”

The techniques are different today, but the incentive and moral results are the same. Hülsmann points to another change: today's princes have “received absolution from the scientific authorities of our day.” Princes used to work in secret to do these things, and be disgraced when caught. Now they announce the policy as responsible statecraft that is consistent with the teaching of modern economics—and the economists stand ready to nod their heads in agreement.

In the face of this, it is time to deal with political reality that no one in Washington (except Ron Paul) is even slightly interested in: an orderly plan to restore sound money. And yet the problems of fiat money and financial collapse cannot go unaddressed. What's more, the institutions of fiat money are failing, and this fact will be undeniably obvious to everyone in a matter of years.

We will look back on the end of the Bush administration as an economic disaster, a capstone of many years of horrible foreign policy moved to domestic policy. They will be disgraced, as will the new administration that pursued all the wrong policy measures as a response. The new messiah will face the same reality that the old one did. No amount of bluster, political will, determined speeches, and money flowing from the printing press can get around the problem of economic reality.

In an essay written at the end of his career, and recently brought back to life by the Mises Institute, F.A. Hayek discusses the only serious means of reform that is open to us. We must completely abolish the central bank. Money itself must be wholly untied from the state. It must be restored as a private good, privately produced for private markets. Government must have no role at all in monetary affairs. Money should be produced by private enterprise alone. Banks must exist only as free-enterprise institutions, with no privileges from the state. This plan has also been advanced by Ron Paul.

What strikes me is how this accords precisely with what Hülsmann writes. His book on the *Ethics of Money Production* ends with a call for an end to all intervention in monetary affairs. Coinage must be private. Banking must receive no privileges. There should be no legal-tender laws, no guarantees, no restrictions on currency use—a fully *laissez-faire* system.

What is further striking about the Hayek, Hülsmann, and Paul idea here is that they offer no plan for restoring a gold dollar. It's not that they would disagree with the idea, but they have fully confronted the reality that the idea of converting the existing currency from fiat money to sound money is essentially a 19th-century ideal that presupposes an enlightened class of political managers. This condition is not met today.

But what is the means? It is the same as we propose in every other area of national life: get the government out. Let the people be free to manage their own affairs. Stop interfering with commercial acts between consenting adults. Stop using violence to interfere with economic affairs. Let the people pursue mutually beneficial exchange based on their own self-assessment of the advantages. Let property owners accept the risk and reward for their own decisions.

It is the same with monetary policy and banking policy too. Let failing banks die. Let profitable banks live. Let the people choose to use any form of money. Let the people choose any means of payment. Let entrepreneurs create any form of financial instrument. Law applies only the way it applies to all other human affairs: punishing force and fraud. Otherwise, the law should have nothing to do with it.

What would be the results? We cannot know for sure. But history can be a guide in our speculations. Throughout all time and in all places, precious metals have emerged as the foundation of the monetary system. I think we can have every expectation that the same would be true today. Evidence comes from how people

turn to gold in difficult times as a store of value, a safehouse from the machinations of government. Gold, in my view, is destined to be the foundation of a new free-market monetary system. It will be the *de facto* result of having no monetary policy at all. A free market in money would work the same as a free market in everything else.

And consider: We are not asking Congress to intervene with a plan. No one is demanding that the Fed adopt this policy as versus that policy. All we are asking is that it not intervene in the attempts by the market to fix the problems that have been created by the central bank and the executive department.

Just imagine what would happen if legal-tender laws were repealed and the government stopped intervention in the market for money. Virtually overnight, we would see the appearance of hundreds if not thousands of new payment systems and alternative monies online. Merchants would be free to accept any means of payment. There would be intense competition among them. Some would be foreign currencies like the Euro. Some would be new currencies based on existing commodities such as gold and silver. I'm certain that we would see a period of wild experimentation take place before the market settled back down again into a standard system that was famed for its reliability and stability and honesty.

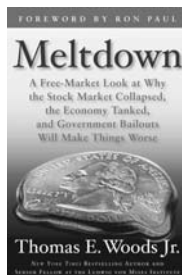
Would we be able to endure the process of discovery? Certainly. We do this every day with our shopping online, or searches for good providers of services and products in the physical world, and our habits on how to invest our money. The market is a process of trial and error, one that never stops innovating and changing. We see everyday on the World Wide Web how this process of creation and change creates the right balance between chaos and order, experimentation and standardization. This would happen in the field of money too.

In fact, it might have happened already had the feds not intervened to stop the rise of alternative payment systems

News from the Institute

Meltdown

Thomas Woods, our senior fellow in residence, is the author of the bestselling book on the economic crisis: *Meltdown*. It has been on the *New York Times* bestseller list and has introduced an entirely new audience to the ideas of the Austrian School. His presence in media interviews has been huge in terms of promoting the books. The book is also notable as the first ever *New York Times* bestseller in the history of the Austrian School. ■



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online. Walmart might have already entered the banking sector. We might have a wide variety of currencies available to us. Google might already have created its own currency based on any number of goods. We might see a more elaborate use of barter in the online world taking shape, and that barter slowly converting itself into currency. This might be based on Google ad points, on PayPal dollars, or some other currency.

Had a free market been permitted to develop over the last ten years, we might have an option today. As it is, we are being forced to stay with a failing dollar system.

What we've been hearing from Washington is that the economy and this country will be patched up by sheer force of will. If we have hope and work together, anything is possible. There is only one thing standing in the way of this wish. It is called economics. Economic

reality is more than a brick wall. It is like the sea or the world's tallest mountain, or like the force of gravity itself. Economic forces pay no attention to the wishes of charismatic leaders and their throngs of adoring followers.

However, there is a kernel of truth in the idea that the force of will can make a difference. Transfer this hope and will outside the institutions of government and into the free market—let experimentation and innovation take place under conditions of freedom—and we will begin to see the emergence of an answer. We need the government merely to let the market be free of political violence, and we will begin to see our way out of this mess.

The government today is marshalling every resource and every means at its disposal to prop up a failing system of the past. Meanwhile, we live in completely new times. These new times are characterized by an international division

of labor, global capital flows, digital information delivery, and the slow but systematic destruction of the establishment in media, banking, and finances. What is emerging to replace them is something that no government on the planet can stop. Markets will not be crushed and they will resist control as never before.

These new times are not the 1930s when a few eggheads in Washington could set most prices and wages and gather the captains of industry to cobble together business cartels. The economic and financial world moves at the speed of light and is so diffuse that no political authority can act quickly enough to control it. The establishment is going down. This is another reason that all believers in freedom have reason to rejoice today.

Twelve to 18 months from now, it will be obvious that there is nothing the new administration can do to patch things up. Obama will be humbled by the market

just as Bush and Clinton were before him, but this time the humbling will overwhelm any attempts to patch things up or put a spin on the much-needed upheaval.

Yes, there is suffering, and there will be more to come. But as a student of the Austrian School and a student of the history of liberty, you have the confidence and clarity to see that freedom alone provides the answers.

It is the time for calm in the face of a storm that few fully understand. Let us, as advocates of freedom, be steadfast, rational, clear, and focused on the long term. Be of good cheer and never stop pointing to the truth about freedom. The answer is not the Left nor the Right nor the state. The way out of this mess is freedom. It is time we defer to it, and to the revolution in the status quo that freedom implies, and give up pretending as if any politician can finally stop it. ■



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