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Aurophobia: Or, Free Banking on What Standard?

In recent years, disillusionment with the record of central banking has led a number of economists to return to the nineteenth-century concept of "free banking": that is, free and unregulated banking without a central bank. Unfortunately, this return has not been toward the Currency Principle/Mises tradition of free banking within a firm matrix of demand liabilities (notes or deposits) grounded in 100 percent reserves in specie (gold or silver). Instead, this new movement has harked back to the contrasting inflationary credit generated by what used to be known as "wildcat banking." In lauding free banking as akin to a free market in any other good or service, these new free bankers have overlooked two vital defects. First, that a genuine free market must be based on an absence of fraud or theft, whereas issuing demand liabilities in excess of assets is equivalent to a warehouse issuing fraudulent receipts to nonexisting assets, and is therefore a species of fraud or embezzlement. And second, the free bankers neglect the insight of Currency Principle men from Ricardo down, that all quantities of money are optimal, and that therefore in stark contrast to all other goods, increased supplies of money can only be redistributive and can confer no social benefit.[1]

On the first point, we contend that bank notes or deposits are bailments and not debt, and that therefore an issue of fractional

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[1]With the exception, of course, of increased nonmonetary benefit from an increase in gold or silver, a gain that cannot accrue from an increase in fiat paper or in fractional-reserve bank credit.

reserve liabilities can only be a violation of the bailment contract. In addition to the pressure of bankers on the law, one of the reasons why the critical court decisions in the nineteenth century ruled the other way is that bailment law was then in an undeveloped state. In the late nineteenth century, and even in the 1930s in the United States, grain warehouses, which, as in the case of banks, issue warehouse receipts to fungible goods, were able to issue, unchecked and unpunished, fraudulent receipts to nonexistent wheat, which they loaned out to speculators in the Chicago wheat market. Interestingly enough, this fractional-reserve process generated a local boom-bust cycle in Chicago wheat.[2] In a genuinely free market, absent force or fraud, bank loans or investments would reflect only their own equity or their genuine debt (e.g., bonds or certificates of deposit), which would constitute genuine credit transactions—exchange of a present good (e.g., money) for a future good (e.g., money at a future date). Free marketeers are sometimes in danger of forgetting that fraud or robbery can be committed by private organizations as well as by government. As Mises favorably quoted Thomas Tooke, "free trade in banking is free trade in swindling."[3]

On the second, more narrowly economic point, from Ricardo to Mises and his followers it has been demonstrated that an increase in the money supply can only dilute the effectiveness of each existing money unit, and therefore must be "inflationary" in the sense of raising prices beyond what they would have been otherwise. In addition, we know from Mises's theory of the business cycle that such inflationary bank credit can only lead to a destructive boom-bust business cycle. And it is not true, on Misesian theory, that central banking is necessary in order to generate this cyclical process. Any bank credit

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[2]Ours is the view of the losing counsel in the 1816 English case of *Devaynes v. Noble*, who argued that "a banker is rather a bailee of his customer's funds than his debtor . . . because the money in . . . [his] hands is rather a deposit than a debt, and may therefore be instantly demanded and taken up." See J. Milnes Holden, *The Law and Practice of Banking*, vol. 1: *Banker and Customer* (London: Pitman, 1970), p. 31; Murray N. Rothbard, *The Mystery of Banking* (New York: Richardson and Snyder, 1983), pp. 87–95.

[3]Ludwig von Mises, *Human Action*, 3rd rev. ed. (Chicago: Henry Regnery, 1963), p. 446.

expansion in commercial loans is sufficient to generate the business cycle, whether a central bank exists or not. In the Misesian view, however, there will tend to be far more room for bank credit expansion whenever a central bank, with its privileging by government and its role as a lender of last resort, is active in the economy.

The recent free bankers have consisted of a coalition of ex-Misesians (White, Selgin, Glasner), English subjectivists (Dowd), and neo-monetarists or neo-Friedmanites (Yeager, Timberlake). Friedman himself, while not totally committed to free banking, has been indicating his disillusion with the Fed's failure to follow his famed Money Rule (in addition to the increasing monetarist difficulty in figuring out which of the various Ms should be subject to that Rule). Hayek may be added to that list, except that he was never a Misesian on this question, at least since the 1930s.

I do not propose here to rehash the substantial controversy between the modern free bankers and the modern Misesians (Rothbard, Salerno, Hoppe, Skousen, North), much less discuss the older 100 percent tradition (most eighteenth-century British economists, including Hume, except Adam Smith; the Currency School; the Jeffersonians and Jacksonians), or the 100 percent fiat paper reserve tradition of the Chicago School (Fisher, Knight, Simons, Hart, and the early Friedman). What I want to do here is to focus on another vitally important, but neglected, area of the free-banking controversy. Assuming for the sake of argument that banks will be free without restrictions to issue demand liabilities to standard money, what, in the view of the free bankers, is that standard money supposed to be? In a sense, this problem is more important and fundamental than the question of the reserve ratio: What is money, and what is going to be the "standard" money, in which these liabilities are supposed to be redeemable on demand?[4]

Oddly enough, the answer to this vital question by the free bankers have been vague, murky, and inconsistent answers that reveal deep and unexamined flaws in the free-banking camp. The

[4]In 1975, at least, Hans F. Sennholz, a former Mises student, had no doubt on the proper answer to this question, as note the title of the book he then edited, *Gold Is Money* (Westport, Conn.: Greenwood Press, 1975). Since then, however, Sennholz has apparently become an ex-Misesian and joined the free-banking camp.

recent booklet by Professor Timberlake in the same vague and murky tradition provides us with an opportunity to examine the views of modern free bankers on the monetary standard, and on what exactly would constitute the "cash" upon which the banks would be allowed to pyramid as many demand liabilities as they could get away with.[5]

Professor Timberlake's work is a curious performance. Ostensibly, it is a brief history of the greenbacks and of the judicial controversy over the constitutionality of the greenbacks and of their legal tender powers. Much of Timberlake's discussion of the Legal Tender Cases is indeed illuminating, since Timberlake is squarely opposed to the constitutionality of fiat money. And yet there are curious distortions and overtones, which build to a climax in the concluding chapters when Timberlake reveals his own positive monetary proposals. For one thing, his attack on greenbacks would seem to imply a pro-gold standard position, and yet throughout his analysis there is a subtle but continuing disparagement of gold which becomes evident when he unrolls his own inflationist, fiat money program. Thus, Timberlake states that the gold standard only existed for four decades in the nineteenth century, omitting the crucial point that from time immemorial only two standard moneys existed, gold and silver, with confusion only emerging from the co-existence either of parallel standards, in which gold or silver were free to fluctuate, or bimetallic standards, in which governments attempted to fix the gold/silver

[5]Hayek's proposal, which can only be considered grotesque, can be dismissed quickly. For Hayek would solve this problem by having each bank create its own fiat paper currency. In short, a Rothbard Bank could issue notes or deposits in 50, 100, and 1,000 Rothbards, which would be redeemable in the same amount of paper Rothbard tickets! Such a bank could of course never fail, but it is doubtful if anyone save close friends and relatives could ever be induced to use and hold these notes and deposits, regardless of what grandiose promises about "price stability" Rothbard might wave in front of potential customers. In addition, Hayek's proposal is absurdly "constructivist" on his own methodological terms. It is doubtful that anyone not a Nobel Laureate making such a proposal would be taken seriously. Thus, see F.A. Hayek, *Denationalisation of Money* (2nd ed., 1976; London: Institute of Economic Affairs, 1978). For a critique, see Murray N. Rothbard, "The Case for a Genuine Gold Dollar," in Llewellyn H. Rockwell, Jr., ed., *The Gold Standard: An Austrian Perspective* (Lexington, Mass.: D.C. Heath Lexington Books, 1985), pp. 2–6; included in this volume as chapter 41.

at a ratio varying from the market. The fact that gold monometallism existed for only a few decades is beside the point, which is the well-deserved monetary longevity of both gold and silver.

Furthermore, while critically analyzing the judicial defenders of greenbacks, Timberlake manages to focus the issue almost exclusively on the illegitimacy of government power to make greenbacks, or fiat paper, legal tender for private contracts. But the power to make paper legal tender for payments to government is left unscathed by Timberlake, which as we shall see seems to fit into his ultimate monetary agenda. This omission contrasts starkly with the magnificently hard-money Jacksonians, who endeavored to end the federal government's power to receive paper or deposits in taxes or fees. The Jacksonians tried, and partially succeeded, in limiting the government to accepting only specie in payments.[6]

Once curious aspect of Timberlake's anti-gold stance is to embrace Milton Friedman's new-found attachment to bimetallism. Timberlake actually refers to Gresham's Law as demonstrating the gently stabilizing effects of bimetallism (pp. 8–9). And yet one of the more valuable insights of monetarism was to demonstrate that fixing of exchange rates inevitably causes distortions by creating shortages of the undervalued, and surpluses of the overvalued, money. From the fourteenth-century French scholastic Nicole Oresme to Ludwig von Mises, Gresham's Law has been seen as the inevitable and unfortunate consequence of maximum price control for the undervalued money and of minimum price control for the overvalued. And yet in pursuit of his lifelong hatred of gold, Milton Friedman seems willing to embrace virtually any alternative, including bimetallism, and Timberlake is willing to follow suit.

Part of Timberlake's problem here is thinness of scholarship. Thus, he discusses the central role of Civil War Secretary of Treasury (and later Chief Justice) Salmon P. Chase, without bothering to mention the national banking system, or Chase's intimate corruptionist

[6]The Jacksonian Democrats, under Van Buren and Polk, were able to impose the Independent Treasury system, in which the federal government kept its money only in its own Treasury vaults, and not in any bank. They did not succeed, however, in requiring the government to accept taxes and fees only in specie. See Major L. Wilson, *The Presidency of Martin Van Buren* (Lawrence: University Press of Kansas, 1984), pp. 61–121.

connection with the investment banker Jay Cooke. He mentions Chase's ambition, and notes with surprise that Chase wanted to run on the Democratic ticket in 1868, without realizing that Chase was an old Jacksonian Democrat, and with slavery defeated there was every reason for him to return to the Democracy. More important, Jay Cooke was an old friend and literal patron of Chase, and Cooke and his influential Ohio journalist brother Henry lobbied the Lincoln Administration heavily and effectively to make their client Chase Secretary of the Treasury. As soon as Chase gained the post, Cooke easily persuaded Chase to grant him the unprecedented power of monopoly underwriter of all government bonds—a monopoly Cooke was able to retain, almost unbroken, until he went bankrupt in the Panic of 1873. Then, Chase went along with Cooke's plan to destroy the decentralized pre-Civil War banking system and to replace it with a quasi-monopoly National Banking System, a system in which the federally chartered national banks had a monopoly privilege to issue notes, and their note issue was based pro rata on how many government bonds they might purchase. The bonds, of course, had to be purchased from Jay Cooke, who also managed to have himself granted several national bank charters. And so, when Timberlake refers crossly to Chase's "patent . . . anti-bank prejudice" (p. 211), he neither seems to understand that that "prejudice" stemmed from Jacksonian hard-money principle, nor that Chase stood ready to violate that principle in behalf of his corruptionist patron Cooke and so created the national banking system.

And while Timberlake correctly notes that the Republicans in this era were inflationist while the Democrats favored gold and hard money, he fails to link up these positions with economic interests. One of the major forces in favor of greenback inflation was the iron and steel industry, centered in Pennsylvania. Under the leadership of the Pennsylvania economist and ironmaster Henry C. Carey, the Radical Republicans and iron and steel interests were instructed that falling dollar rates caused by greenback inflation acted as a temporary but welcome extra tariff, discouraging iron and steel imports and encouraging their export. The other major inflationist interest was the big railroads, the major big businesses and incorporated enterprises in the country. Heavily indebted to their bondholders, the railroads saw that inflation would lower the real value of their outstanding debts. Thus, Timberlake correctly notes the significance of the action of the Grant administration in appointing two Supreme Court Justices to fill vacancies. The Administration was sure these judges would quickly reverse the Legal Tender Cases and declare greenbacks and fiat money constitutional. Timberlake notes that these two swing justices were William Strong and Joseph P. Bradley, but fails to make the important point that Strong had been a top attorney for the Philadelphia and Reading Railroad, and a director of the Lebanon Valley Railroad; and as for Bradley, his connections with the railroad interests were almost as great, having been a director of the Camden and Amboy Railroad and of the Morris and Essex Railroad, both in New Jersey.[7]

One pervading problem is that Timberlake's scholarship is spotty. Thus, on the post-Civil War monetary situation, there is reference to Irwin Unger's *The Greenback Era*, but no mention whatever of the equally important Robert P. Sharkey, *Money, Class and Party: An Economic Study of Civil War and Reconstruction* (Baltimore: Johns Hopkins University Press, 1959). Timberlake mentions Bray Hammond's classic *Banks and Politics in America*, but overlooks Hammond's important *Sovereignty and an Empty Purse: Banks and Politics in the Civil War* (Princeton, N.J.: Princeton University Press, 1970). He uses the splendidly hard-money Don C. Barrett's article in the *Quarterly Journal of Economics* (May 1902), but omits Barrett's fully developed book, *Greenbacks and the Resumption of Specie Payments, 1862–1879* (Cambridge: Harvard University Press, 1931). And how can anyone, as Timberlake does, deal with silver and bimetallism without so much as mentioning the famed revisionist article by Paul M. O'Leary, "The Scene of the Crime of 1873 Revisited: A Note," (*Journal of Political Economy* 68 [1960]: 388–92), or the splendid work by Allen Weinstein, *Prelude to Populism: Origins of the Silver Issue 1867–1878* (New Haven, Conn.: Yale University Press, 1970)?

Perhaps the problem is that Professor Timberlake, or his Durrell Foundation editor, John W. Robbins, was anxious to rush past the history to get to the policy conclusions, the monetary agenda which is only loosely based on the preceding historical discussion. In his

[7]Ron Paul, *The Ron Paul Money Book* (Clute, Texas: Plantation Publishing, 1991), pp. 115–16. On the railroad ties of Strong and Bradley, see Philip H. Burch, Jr., *Elites in American History*, vol. 2: *The Civil War to the New Deal* (New York: Holmes & Meier, 1981), pp. 44–45.

conclusion, Timberlake brusquely dismisses the gold standard. Gold, he says, has been subject to government manipulation by central banks. Very true, but how about the gold standard that also abolished the central bank? This Misesian solution is not mentioned, nor indeed is the extensive Jacksonian literature to the same effect. Timberlake states as if a new point that under the gold standard government need not have minted gold coins, a theme that has long been part of the Misesian literature. He need scarcely rely for reference on a forthcoming article by J. Huston McCulloch. Timberlake only bothers making two other negative references to justify his dismissal of gold. One, that gold might "shut out technically more efficient systems" (p. 52), whatever they might be, but without pointing out that efficient clearing systems can be and have been based on standard metallic money. His other point is the disingenuous one that even Ludwig von Mises, a champion of gold, admits that gold "introduces an incalculable factor into economic activity" (p. 47). But Timberlake fails to note Mises's very next point: that this incalculable factor, stemming from variations in the supply of gold, has been minuscule compared to the volatility introduced by government and by bank manipulations of the supply of money.[8]

What then is Professor Timberlake's proffered alternative, one which he avows would "more effectively constrain the state" than the gold standard (p. 52)? What, in Timberlake's words, "is a market-directed monetary system completely free from any possible government intervention" (p. 62)? Or to return to our earlier question, in Timberlake's proposed world, in what thing would banks liabilities be redeemable? The one cogent note in Hayek's bizarre "denationalized currency" scheme is the pungent clarity of his answer: banks that issue Hayeks, Rothbards, and ducats would redeem these paper tickets or open book liabilities in Hayeks, Rothbards, and ducats. Timberlake, unfortunately, is not nearly so clear. He does seem to realize that Americans are stuck with "dollars" as their currency unit and standard, just as Englishmen are stuck with pounds and Germans marks. He does not, however, explain why these countries are necessarily stuck with currency names. Instead, he becomes even murkier by adopting the curious and grotesquely "constructivist" plan of

[8]Ludwig von Mises, *The Theory of Money and Credit* (1934; Indianapolis, Ind.: LibertyClassics, 1980), p. 27.

Greenfield and Yeager: that the monetary unit of account be totally and ineluctably sundered from the medium of exchange. The monetary unit would still be the dollar, but how then is the "dollar" to be defined? Originally, the dollar, along with every national currency, was simply defined as a definite unit of weight of gold or silver. Before 1933, for example, the "dollar," the monetary standard in the United States, was defined as 1/20 of an ounce of gold. Nowadays, of course, the "dollar" is fiat; it is simply a paper ticket issued by the Federal Reserve System that says, on its face, "one dollar" or "ten dollars."

What would Timberlake do about this; or, following Greenfield and Yeager, how would he proceed to "the practical purpose of getting the government [in the guise of the Federal Reserve System] out of any policy-making role" (p. 60)? By severing the dollar from the medium of exchange. The government would define the "dollar" as equal "to a market price index made up of a limited array of staple, conventional, basic commodities—items that would ideally mirror an all-markets average of prices." But if the government defines the dollar as an overall price index, wouldn't this definition be subjected to political pressure for continually redefining the index; and wouldn't the government almost automatically strive to stabilize the price level as gauged by its precious index? No, because incredibly, according to Timberlake, Greenfield and Yeager, the government would be sternly advised not to stabilize its own index. But does anyone in his right mind, anyone at all familiar with our political system, think for one moment that the government would thus keep its hands off its own index?[9]

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[9]Professor Timberlake would have done well to heed Mises's insights about index numbers in the passage just before the sentence he yanked out of context:

> If it should be thought that index numbers offer us an instrument for providing currency policy with a solid foundation and making it independent of the changing economic programs of governments and political parties, perhaps I may be permitted to refer to what I have said . . . on the impossibility of singling out any particular method of calculating index numbers as the sole scientifically correct one. . . . There are many ways of calculating purchasing power by means of index numbers, and every single one of them is right, from certain tenable points of view; but

And what, too, would be the medium of exchange in Timberlake's system, and would that medium be redeemable in the dollar-index? None of that is clear. If it is redeemable, then presumably people would not be walking around with index market-baskets; if instead, it is to be redeemable in the "purchasing power" of the index, then we are back to stabilizing the price level, and also in what would the medium be redeemed, and would that index then become the medium? If not, and if there is to be no redemption whatever, then who is to supply the medium of exchange, and what is to keep the "free" money suppliers from issuing money *ad infinitum*? (In the gold standard, of course, what keeps the banks at least partially in check is the necessity to redeem in gold.) Timberlake is of little help in supplying this crucial answer.[10] At one point he refers to the "medium of exchange [as] the Federal Reserve note" (p. 60)! That's getting the government and the Fed "out of any policymaking role?" At another point, he inconsistently "would leave this function [supply the quantity of money] to dealers and arbitrageurs in financial and commodity markets" (p. 60). What is all this supposed to mean? At another point, the confusion is even worse compounded by Timberlake's calling for "privatizing" the government's gold stockpile "and the twelve Federal Reserve Banks" (p. 62). Privatizing the Federal Reserve? What can this mean? In a profound sense, the Federal

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> every single one of them is also wrong. . . . Since each method of calculation will yield results that are different from those interests and injure others, it is obvious that each group of persons will declare for those methods that will best serve its own interests. (Mises, *Theory of Money and Credit*, pp. 26–27)

Also see Mises's scintillating critique of index numbers in ibid., pp. 215–23.

[10]Greenfield and Yeager are not much more helpful either. In contrast to Timberlake's hint about "privatized" Federal Reserve notes still constituting the medium of exchange, Greenfield and Yeager avow the absence of "any dominant" medium of exchange, which seems close to calling for no general medium of exchange at all, and hence a return to some form of barter. Greenfield and Yeager also propose a convenient new criterion for the advance of science: that the burden of proof to clarify and persuade others of a totally new proposal, such as theirs, should rest on the readers bound in their old frameworks rather than on the authors themselves. R. Greenfield and L. Yeager, "Competitive Payment Systems: Comment," *American Economic Review* 76 (September 1986): 848–49.

Reserve, as well as all previous central banks, are already "private"—a government-established and enforced cartel of the private banking system. Are we then to be stuck forever with Federal Reserve notes as "dollars," whether or not they are officially defined as such? Privatizing the Fed is about as cogent, and about as genuinely free-market-oriented, as the idea of "privatizing" the Internal Revenue Service. No, it is important to realize that those government operations which supply or monopolize genuine goods and services should be privatized—e.g., carrying the mail, supplying streets and roads, putting out fires. But other government activities, which are counterproductive and destructive to the market—e.g., the IRS, government regulatory commissions, concentration camps for dissenters—should not be privatized but abolished. Surely, that massive monopolistic and inflationary engine of legalized and legitimated counterfeiting called the Federal Reserve System should be abolished rather than privatized.

In supporting the idea of sundering the unit of account from the medium of exchange, Timberlake fallaciously refers to the researches into medieval money of the great economic historian Luigi Einaudi.[11] But he fails to realize that in his historical cases, Einaudi was not writing about an abstract unit of account of "imaginary money" that came from the sky or from professors and was never used as a medium of exchange. On the contrary, in all cases, Einaudi was referring to the bimetallic or parallel metallic situation in which units of weight of gold (or silver) was the medium of exchange in a certain country, whereas units of weight of the other precious metal, silver (or gold) functioned as the unit of account. In this situation, both gold and silver originally emerged, on the market, as media of exchange and hence units of account. Not only do Einaudi's cases

[11]In addition to citing Einaudi's article in the Gayer Festschrift for Irving Fisher, Timberlake might have momentarily strengthened his case by referring to the impressive article by Luigi Einaudi, "The Theory of Imaginary Money from Charlemagne to the French Revolution," in F.C. Lane and J.C. Riemersma, eds., *Enterprise and Secular Change* (Homewood, Ill.: Richard D. Irwin, 1953), pp. 229–61. The Einaudi article was originally written in *Rivista de storia economica*, 1936, and its English translation by Giorgio Tagliacozzo was approved and added to by Einaudi.

not constitute historical support for the Timberlake-Greenfield-Yeager scheme; they are precisely the reverse.[12]

The problem with all these plans, from Greenfield and Yeager to Timberlake to Hayek, is that they ignore one of Ludwig von Mises's most original and profound contributions to monetary theory: the "regression theorem," which demonstrates that no money can originate in any society except as a medium of exchange, and as a medium that arose on the free market as a useful nonmonetary commodity, e.g., gold or silver.[13] Hence, the regression theorem explains the fallacy and the dismal prospects for all such constructivist schemes as the magic index or the Hayekian ducat. The reason why we must start with the dollar as the money for Americans, the franc as the money for the French, etc., is that the people of these countries are used to those units of account, and since those units grew originally out of a unit of weight of gold or silver, they were useful nonmonetary commodities on the market before they became employed as moneys.[14]

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[12]On the theory of parallel standards, see Mises, *The Theory of Money and Credit*, pp. 205–13. For historical examples of parallel standards, see also W. Stanley Jevons, *Money and the Mechanism of Exchange* (London: Kegan Paul, 1905), pp. 88–96. Robert S. Lopez points out that whereas gold coinage was introduced into modem Europe almost simultaneously in the mid-thirteenth century by Florence and Genoa, Florence instituted bimetallism, whereas "Genoa, on the contrary, in conformity to the principle of restricting state intervention as much as possible, did not try to enforce a fixed relation between coins of different metals." Robert S. Lopez, "Back to Gold, 1252," *Economic History Review* (December 1956): 224.

[13]On the regression theorem, see Mises, *The Theory of Money and Credit*, pp. 129–59; *Human Action*, pp. 408–16.

[14]Greenfield and Yeager, dismissing the relevance of the point that their monetary scheme could never emerge from the market, argue that "dismantling government domination of the existing system will require deliberate policy actions, and the positive actions taken will unavoidably condition the successor system." Greenfield and Yeager, "Competitive Payments Systems," p. 849. But it is precisely because economic history is path-dependent that we don't want to foist upon the future a system that will not work, and that will not work largely because such indices and media cannot emerge "organically" from individual actions on the market. Surely, the idea in dismantling the government and returning (or advancing) to a free market is to be as

If we really wish, then, to separate government from monetary policy or from monetary functions, we must totally divest government of those roles. We must therefore start with reality—the dollar defined as a government paper ticket or Federal Reserve note—and proceed to privatize the dollar precisely by ending its relationship to the note, and by redefining it as a unit of weight of gold. How is this to be done? By abolishing the Federal Reserve System. Abolishing that "corporation" means, as in the death of any corporation, liquidating its liabilities, and parcelling out the assets of the liquidated organization to its creditors. Since Federal Reserve notes are legally liabilities of the Fed, and since its assets are the Fed's accumulated gold stock kept in Fort Knox and other Treasury repositories, the gold should be parcelled out pro rata to the Fed's creditors (holders of Federal Reserve notes and banks that keep demand deposits at the Fed). The dollar would be redefined in units of weight of gold to permit 100 percent liquidation as well as the exchange of gold assets for all liquidated notes and liabilities. As its last monetary function, the Treasury could mint the gold coins out of the deposited bullion to exchange for these notes and deposits. The money supply would then consist solely of gold coins, which could be deposited for warehouse receipts in commercial banks. Federal Reserve notes and deposits would then have disappeared.[15]

One of the few places where I agree with Professor Timberlake's prescription is to "privatize the government's stockpile of gold." But of course legally the gold is owned not by the government *per se* but by the Federal Reserve; and therefore the only way to privatize the

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consonant with the market as possible, and to eliminate government intervention with the greatest possible dispatch. Foisting upon the public a bizarre scheme at variance with the nature and functions of money and of the market, is precisely the kind of technocratic social engineering from which the world has suffered far too much in the twentieth century.

[15]What of the government securities that now constitute the bulk of the assets of the Federal Reserve System? An urge for genuine privatization and a decent respect for the taxpayer would require the immediate writing off of these bonds; why should the taxpayer be forced to pay interest and principal when one agency of the federal government owns the bonds of another? With the exception, of course, of increased nonmonetary benefit from an increase in gold or silver, a gain that cannot accrue from an increase in fiat paper or in fractional-reserve bank credit.

gold stock, and at one and the same time to abolish the Federal Reserve and to return from a fiat to a gold standard, would be the plan I have described above: redefinition of the dollar as a unit of weight of gold, and abolition of the Fed and the disgorging of its gold stock, to be exchanged, one for one, for its liquidated liabilities, the Fed's notes and deposits.

I submit that we would then have a gold standard without a central bank, without fiat money, without Federal Reserve notes, and with none of the actualities or even possibilities of government intervention that Professor Timberlake professes to abhor. But for Timberlake, or for Greenfield or Yeager, to adopt such a plan, would require them to abandon once and for all, their flight from gold, that veritable phobia about gold, or "aurophobia," that has marked all respectable schools of economic thought, whether Keynesian or monetarist, for most of the inflationist twentieth century.

Section Seven

Criticism

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Milton Friedman Unraveled

Mention "free-market economics" to a member of the lay public and chances are that if he has heard the term at all, he identifies it completely with the name Milton Friedman. For several years, Professor Friedman has won continuing honors from the press and the profession alike, and a school of Friedmanites and "monetarists" has arisen in seeming challenge to the Keynesian orthodoxy.

However, instead of the common response of reverence and awe for "one of our own who has made it," libertarians should greet the whole affair with deep suspicion: "If he's so devoted a libertarian, how come he's a favorite of the Establishment?" An advisor of Richard Nixon and a friend and associate of most administration economists, Friedman has, in fact, made his mark in current policy, and indeed reciprocates as a sort of leading unofficial apologist for Nixonite policy.

In fact, in this as in other such cases, suspicion is precisely the right response for the libertarian, for Professor Friedman's particular brand of "free-market economics" is hardly calculated to ruffle the feathers of the powers-that-be. Milton Friedman is the Establishment's Court Libertarian, and it is high time that libertarians awaken to this fact of life.

The Chicago School

Friedmanism can be fully understood only in the context of its historical roots, and these roots are the so-called "Chicago School"

Originally published in *The Individualist* in 1971.

of economics of the 1920s and 1930s. Friedman, a professor at the University of Chicago, is now the undisputed head of the modern, or second-generation, Chicago School, which has adherents throughout the profession, with major centers at Chicago, UCLA, and the University of Virginia.

The members of the original, or first-generation, Chicago School were considered "leftish" in their day, as indeed they were by any sort of genuine free-market criterion. And while Friedman has modified some of their approaches, he remains a Chicago man of the thirties.

The political program of the original Chicagoans is best revealed in the egregious work of a founder and major political mentor: Henry C. Simons's *A Positive Program for Laissez Faire*.[1] Simons's political program was laissez faireist only in an unconsciously satiric sense. It consisted of three key ideas:

(1) a drastic policy of trust-busting of all business firms and unions down to small blacksmith-shop size, in order to arrive at "perfect" competition and what Simons conceived to be the "free market";

(2) a vast scheme of compulsory egalitarianism, equalizing incomes through the income-tax structure; and

(3) a proto-Keynesian policy of stabilizing the price-level through expansionary fiscal and monetary programs during a recession.

Extreme trust-busting, egalitarianism, and Keynesianism: the Chicago School contained within itself much of the New Deal program, and, hence, its status within the economics profession of the early 1930s as a leftish fringe. And while Friedman has modified and softened Simons's hard-nosed stance, he is still, in essence, Simons redivivus; he only appears to be a free-marketeer because the remainder of the profession has shifted radically leftward and stateward in the meanwhile. And, in some ways, Friedman has added unfortunate statist elements that were not even present in the older Chicago School.[2]

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[1]Henry C. Simons, *A Positive Program for Laissez Faire: Some Proposals for a Liberal Economic* Policy (Chicago: University of Chicago Press, 1934).

[2]In this article, I am confining discussion to the politico-economic, and omitting the technical problems of economic theory and methodology. It is

The Chicago School on Monopoly and Competition

Let us take the leading elements of Simonsian collectivist laissez faire in their turn. On monopoly and competition, Friedman and his colleagues have happily come a long way toward rationality from the old ultra-trust-busting of Simons. Friedman now concedes that the major source of monopoly in the economy is the activity of government, and focuses on repeal of these monopolizing measures.

The Chicagoans have gotten progressively more friendly to large business operating on the free market, and such Friedmanites as Lester Telser have even emerged with excellent arguments on behalf of advertising, previously anathema to all "perfect competitionists." But while in practice Friedman has become more libertarian on the monopoly question, he still retains the old Chicagoite theory: that in some way, the absurd, unreal, and unfortunate world of "perfect competition" (a world in which every firm is so minute that nothing it does can affect its demand and the price of its products) is better than the real, existing world of competition, which is dubbed "imperfect."

An infinitely superior view of competition is found in the totally neglected school of "Austrian economics" which scorns the "perfect competition" model and prefers the real world of free-market competition.[3] So while Friedman's practical view of competition and monopoly is not too bad, the weakness of his underlying theory could permit at any time a return to the frenetic trust-busting of the Chicagoans of the 1930s. It was not very long ago, for example, that Friedman's most distinguished associate, Professor George J. Stigler, advocated before Congress the trust-busting break-up of U.S. Steel into many constituent parts.

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in the latter where Friedman has been at his worst, for Friedman has managed to change the older Chicagoan methodology, in its essence Aristotelian and rationalist, to an egregious and extreme variant of positivism.

[3]For an excellent introduction to the Austrian view, see of F.A. Hayek, *Individualism and the Economic Order* (Chicago: University of Chicago Press, 1948), chap. 5.

Friedman's Chicagoite Egalitarianism

While Friedman has abandoned Simons's call for extreme egalitarianism through the income tax structure, the basic lineaments of statist egalitarianism still remain. It remains in the Chicagoite desire to lay the tax structure's greatest stress on the income tax, undoubtedly the most totalitarian of all taxes. Chicagoites prefer the income tax because, in their economic theory, they follow the disastrous tradition of orthodox Anglo-American economics in sharply separating the "microeconomic" from the "macroeconomic" spheres.

The idea is that there are two sharply separated and independent worlds of economics. On the one hand, there is the "micro" sphere, the world of individual prices determined by the forces of supply and demand. Here, the Chicagoans concede, the economy is best left to the unhampered play of the free market. But, they assert, there is also a separate and distinct sphere of "macro" economics, of economic aggregates of government budget and monetary policy, where there is no possibility or even desirability of a free market.

In common with their Keynesian colleagues, the Friedmanites wish to give to the central government absolute control over these macro areas, in order to manipulate the economy for social ends, while maintaining that the micro world can still remain free. In short, Friedmanites as well as Keynesians concede the vital macro sphere to statism as the supposedly necessary framework for the micro-freedom of the free market.

In reality, the macro and micro spheres are integrated and intertwined, as the Austrians have shown. It is impossible to concede the macro sphere to the State while attempting to retain freedom on the micro level. Any sort of tax, and the income tax not least of all, injects systematic robbery and confiscation into the micro sphere of the individual, and has unfortunate and distortive effects on the entire economic system. It is deplorable that the Friedmanites, along with the rest of Anglo-American economics, have never paid attention to the achievement of Ludwig von Mises, founder of the modern Austrian School, in integrating the micro and macro spheres in economic theory as far back as 1912 in his classic *The Theory of Money and Credit*.[4]

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[4]Ludwig von Mises, *The Theory of Money and Credit*, trans. H.E. Batson (Indianapolis, Ind.: LibertyClassics, 1980).

Milton Friedman has revealed his quintessential pro-income tax and egalitarian position in numerous ways. As in many other spheres, he has functioned not as an opponent of statism and advocate of the free market, but as a technician advising the State on how to be more efficient in going about its evil work. (From the viewpoint of a genuine libertarian, the more inefficient the State's operations, the better![5]) He has opposed tax exemptions and "loopholes" and worked to make the income tax more uniform.

One of Friedman's most disastrous deeds was the important role he proudly played, during World War II in the Treasury Department, in foisting upon the suffering American public the system of the withholding tax. Before World War II, when income tax rates were far lower than now, there was no withholding system; everyone paid his annual bill in one lump sum, on March 15. It is obvious that under this system, the Internal Revenue Service could never hope to extract the entire annual sum, at current confiscatory rates, from the mass of the working population. The whole ghastly system would have happily broken down long before this. Only the Friedmanite withholding tax has permitted the government to use every employer as an unpaid tax collector, extracting the tax quietly and silently from each paycheck. In many ways, we have Milton Friedman to thank for the present monster Leviathan State in America.

In addition to the income tax itself, Friedman's egalitarianism is revealed in the Friedman-Stigler pamphlet attacking rent controls. "For those, like us, who would like even more equality than there is at present . . . it is surely better to attack directly the existing inequalities in income and wealth at their source" than to restrict the purchases of particular commodities, like housing.[6]

The single most disastrous influence of Milton Friedman has been a legacy from his old Chicagoite egalitarianism: the proposal for a guaranteed annual income to everyone through the income tax system—an idea picked up and intensified by such leftists as Robert

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[5]There is a charming anecdote about the distinguished industrialist Charles F. Kettering. Visiting the hospital bed of a friend who was complaining about the growth of government, Kettering told him "Cheer up Jim. Thank God we don't get as much government as we pay for!"

[6]Milton Friedman and George J. Stigler, *Roofs or Ceilings?* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1946), p. 10.

Theobald, and one which President Nixon will undoubtedly be able to ram through the new Congress.[7]

In this catastrophic scheme, Milton Friedman has once again been guided by his overwhelming desire not to remove the State from our lives, but to make the State more efficient. He looks around at the patchwork mess of local and state welfare systems, and concludes that all would be more efficient if the whole plan were placed under the federal income tax rubric and everyone were guaranteed a certain income floor. More efficient, perhaps, but also far more disastrous, for the only thing that makes our present welfare system even tolerable is precisely its inefficiency, precisely the fact that in order to get on the dole one has to push one's way through an unpleasant and chaotic tangle of welfare bureaucracy. The Friedman scheme would make the dole automatic, and thereby give everyone an automatic claim upon production.

Welfare's "Supply Function"

We have to realize that being on welfare is not, as most people believe, a simple and absolute act of God or nature, a stark given like a volcanic eruption. Being-on-welfare, like all other human economic acts, has a "supply function": in other words, if you make welfare pay enough, you can produce as many welfare clients as you wish to have. Pay them little enough and you can reduce the number of clients at will. In short, if the government should announce that anyone who signs up at a "welfare" desk gets an automatic annual check of $40,000 for as long as he wishes, we will find soon enough that almost everyone has become a welfare recipient—and what is more, will join a "welfare rights" organization to lobby for $60,000 to offset the rise in the cost of living.

More specifically, the supply function of welfare clients is inversely proportional to the difference between the prevailing wage rate in the area and the level of welfare payments. This difference is the "opportunity cost" of going on welfare—the amount that one loses by loafing instead of working. If, for example, the prevailing

[7]For a further critique of the Friedman-Nixon guaranteed income doctrine, see Murray N. Rothbard, "The Guaranteed Annual Income," *The Rational Individualist* (September 1969); and Henry Hazlitt, *Man vs. The Welfare State* (New Rochelle, N.Y.: Arlington House, 1969), pp. 62–100.

wage rises in an area and the welfare payments remain the same, the differential and the "opportunity cost" of loafing rise, and people tend to leave the welfare dole and go to work. If the opposite happens, more people will go on the dole. If being on welfare were an absolute fact of nature, then there would be no relation between this differential and the number on welfare.[8]

Second, the supply of welfare clients is inversely proportional to another vitally important factor: the cultural or value disincentive of going on welfare. If this disincentive is strong, if, for example, an individual or group strongly believes that it is evil to go on welfare, they will not do it, period. If, on the other hand, they do not care about the stigma of welfare, or, worse yet, they regard welfare payments as their right—a right to exert a compulsory, looting claim upon production—then the number of people on welfare will increase astronomically, as has happened in recent years.

There are several recent examples of the "stigma effect." It has been shown that, given the same level of income, more people tend to go on welfare in urban than in rural areas, presumably as a function of the greater visibility of welfare clients and hence the greater stigma in the more sparsely populated region. More important, there is the glowing fact that certain religious groups, even when significantly poorer than the rest of the population, simply do not go on welfare because of their deeply held ethical beliefs. Thus, the Chinese-Americans, while largely poor, are almost never to be found on welfare. A recent article on Albanian-Americans in New York City highlights that same point. These Albanians are invariable poor slum dwellers, and yet there is no Albanian-American on welfare. Why? Because, said one of their leaders, "Albanians do not beg, and to Albanians, taking welfare is like begging in the street."[9]

Another example is the Mormon Church, very few of whose members are on public welfare. For the Mormons not only inculcate in their members the virtues of thrift, self-help, and independence, they also take care of their own needy through church charity programs which

[8]For an empirical demonstration of this relationship, see C.T. Brehm and T.R. Saving, "The Demand for General Assistance Payments," *American Economic Review* 54, no. 6 (December 1964): 1002–18.

[9]*New York Times* (April 13, 1970).

are grounded on the principle of helping people to help themselves, and thereby getting them off charity as quickly as possible.[10] Thus, the Mormon Church counsels its members that "to seek and accept direct public relief all too often invites the curse of idleness and fosters the other evils of dole. It destroys one's independence, industry, thrift, and self-respect."[11] Hence, the Church's highly successful private welfare program is based on the principles that

> the Church has encouraged its members to establish and maintain their economic independence: it has encouraged thrift and foster the establishment of employment-creating industries; it has stood ready at all times to help needy faithful members.

And:

> Our primary purpose was to set up, in so far as it might be possible, a system under which the curse of idleness would be done away with, the evils of a dole abolished, and independence, industry, thrift, and self-respect be once more established among our people. The aim of the Church is to help the people help themselves. Work is to be re-enthroned as the ruling principles of the lives of our Church membership. . . . Faithful to this principle, welfare workers will earnestly teach and urge Church members to be self-sustaining to the full extent of their powers. No true latter-day Saint will, while physically able, voluntarily shift from himself the burden of his own support.[12]

The Libertarian approach to the welfare problem, then, is to abolish all coercive, public welfare, and to substitute for it private charity based on the principle of encouraging self-help, bolstered also

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[10]This was the same principle as the one guiding the Charity Organization Society in nineteenth-century England. That classical-liberal organization "believed that the most serious aspect of poverty was the degradation of the character of the poor man or woman. Indiscriminate charity only made things worse; it demoralized. True charity demanded friendship, thought, the sort of help that would restore a man's self-respect and his ability to support himself and his family." Charles Loch Mowat, *The Charity Organization Society* (London: Methuen, 1961), p. 2.

[11]*Welfare Plan of the Church of Jesus Christ of Latter-Day Saints* (The General Church Welfare Committee, 1960), p. 48.

[12]Ibid., pp. 1–2.

by inculcating the virtues of self-reliance and independence throughout society.

Incentives under the Friedman Plan

But the Friedman plan, on the contrary, moves in precisely the opposite direction, for it establishes welfare payments as an automatic right, an automatic, coercive claim upon the producers. It thereby removes the stigma effect altogether, disastrously discourages productive work by steep taxation, and by establishing a guaranteed income for not working, which encourages loafing. In addition, by establishing an income floor as a coercive "right," it encourages welfare clients to lobby for ever-higher floors, thus continually aggravating the entire problem. But Friedman, caught in the Anglo-American separation of "micro"and "macro," gives very little attention to these cataclysmic effects on incentives.

Even the handicapped are hampered by the Friedmanite plan, for an automatic dole removes the marginal incentive for the handicapped worker to invest in his own vocational rehabilitation, since the net monetary return from such investment is now greatly lowered. Hence, the guaranteed income tends to perpetuate these handicaps. Finally, the Friedmanite dole would pay a higher income per person to welfare families, thereby subsidizing a continuing increase in the child population among the poor—precisely those who can least afford such a population growth. Without joining in the current hysteria about the "population explosion," it is certainly absurd to deliberately subsidize the breeding of more pauper-children, which is what the Friedman plan would do as an automatic right.

Money and the Business Cycle

The third major feature of the New Deal program was proto-Keynesian: the planning of the "macro" sphere by the government in order to iron out the business cycle. In his approach to the entire area of money and the business cycle—an area on which unfortunately Friedman has concentrated most of his efforts—Friedman harks back not only to the Chicagoans, but, like them, to Yale economist Irving Fisher, who was the Establishment economist from the 1900s through the 1920s. Friedman, indeed, has openly hailed Fisher as the "greatest economist of the twentieth century," and when one reads Friedman's writings, one often gets the impression of reading

Fisher all over again, dressed up, of course, in a good deal more mathematical and statistical mumbo-jumbo. Economists and the press, for example, have been hailing Friedman's recent "discovery" that interest rates tend to rise as prices rise, adding an inflation premium to keep the "real" rate of interest the same; this ignores the fact that Fisher had pointed this out at the turn of the twentieth century.

But the key problem with Friedman's Fisherine approach is the same orthodox separation of the micro and macro spheres that played havoc with his views on taxation. For Fisher believed, again, that on the one hand there is a world of individual prices determined by supply and demand, but on the other hand there is an aggregate "price level" determined by the supply of money and its velocity of turnover, and never the twain do meet. The aggregate, macro, sphere is supposed to be the fit subject of government planning and manipulation, again supposedly without affecting or interfering with the micro area of individual prices.

Fisher on Money

In keeping with this outlook, Irving Fisher wrote a famous article in 1923, "The Business Cycle Largely a 'Dance of the Dollar'"—recently cited favorably by Friedman—which set the model for the Chicagoite "purely monetary" theory of the business cycle. In this simplistic view, the business cycle is supposed to be merely a "dance," in other words, an essentially random and causally unconnected series of ups and downs in the "price level." The business cycle, in short, is random and needless variations in the aggregate level of prices. Therefore, since the free market gives rise to this random "dance," the cure for the business cycle is for the government to take measures to stabilize the price level, to keep that level constant. This became the aim of the Chicago School of the 1930s, and remains Milton Friedman's goal as well.

Why is a stable price level supposed to be an ethical idea, to be attained even by the use of governmental coercion? The Friedmanites simply take the goal as self-evident and scarcely in need of reasoned argument. But Fisher's original groundwork was a total misunderstanding of the nature of money, and of the names of various currency units. In reality, as most nineteenth century economists knew full well, these names (dollar, pound, franc, etc.) were not somehow realities in themselves, but were simply names for units of weight of gold or silver. It was these commodities, arising in the free market, that were the genuine moneys; the names, and the paper money and bank money, were simply claims for payment in gold or silver. But Irving Fisher refused to recognize the true nature of money, or the proper function of the gold standard, or the name of a currency as a unit of weight in gold. Instead, he held these names of paper money substitutes issued by the various governments to be absolute, to be money. The function of this "money" was to "measure" values. Therefore, Fisher deemed it necessary to keep the purchasing power of currency, or the price level, constant.

This quixotic goal of a stable price level contrasts with the nineteenth-century economic view—and with the subsequent Austrian School. They hailed the results of the unhampered market, of laissez faire capitalism, in invariably bringing about a steadily falling price level. For without the intervention of government, productivity and the supply of goods tends always to increase, causing a decline in prices. Thus, in the first half of the nineteenth century—the "Industrial Revolution"—prices tended to fall steadily, thus raising the real wage rates even without an increase of wages in money terms. We can see this steady price decline bringing the benefits of higher living standards to all consumers, in such examples as TV sets falling from $2000 when first put on the market to about $100 for a far better set. And this in a period of galloping inflation.

It was Irving Fisher, his doctrines, and his influence, which was in large part responsible for the disastrous inflationary policies of the Federal Reserve System during the 1920s, and therefore for the subsequent holocaust of 1929. One of the major aims of Benjamin Strong, head of the Federal Reserve Bank (Fed) of New York and virtual dictator of the Fed during the 1920s, was, under the influence of the Fisher doctrine, to keep the price level constant. And since wholesale prices were either constant or actually falling during the 1920s, Fisher, Strong, and the rest of the economic Establishment refused to recognize that an inflationary problem even existed. So, as a result, Strong, Fisher, and the Fed refused to heed the warnings of such heterodox economists as Ludwig von Mises and H. Parker Willis during the 1920s that the unsound bank credit inflation was leading to an inevitable economic collapse. So pig-headed were these worthies that, as late as 1930, Fisher, in his swansong as economic prophet, wrote that there was no depression, and that the stock market collapse was only temporary.[13]

Friedman on Money

And now, in his highly touted *Monetary History of the United States*, Friedman has demonstrated his Fisherine bias in interpreting American economic history.[14] Benjamin Strong, undoubtedly the single most disastrous influence upon the economy of the 1920s, is lionized by Friedman for his inflation and price-level stabilization during that decade.[15] In fact, Friedman attributes the 1929 depression not to the preceding inflation boom but to the failure of the post-Strong Federal Reserve to inflate the money supply enough before and during the depression.

In short, while Milton Friedman has performed a service in bringing back to the notice of the economics profession the overriding influence of money and the money supply on business cycles, we must recognize that this "purely monetarist" approach is almost the exact reverse of the sound—as well as truly free-market—Austrian view. For while the Austrians hold that Strong's monetary expansion made a later 1929 crash inevitable, Fisher-Friedman believe that all the Fed needed to do was to pump more money in to offset any recession. Believing that there is no causal influence running from boom to bust, believing in the simplistic "Dance of the Dollar" theory, the Chicagoites simply want government to manipulate that dance, specifically to increase the money supply to offset recession.

During the 1930s, therefore, the Fisher-Chicago position was that, in order to cure the depression, the price level needed to be

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[13]Irving Fisher, *The Stock Market Crash—And After* (New York: Macmillan, 1930).

[14]Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton, N.J.: Princeton University Press, 1963).

[15]See Murray N. Rothbard, *America's Great Depression* (Princeton, N.J.: D. Van Nostrand, 1963), for a contrasting view of the 1920s. More on the Friedmanite vs. Austrian view of the business cycle can be found in Murray N. Rothbard, "The Great Inflationary Recession Issue: 'Nixonomics' Explained," *The Individualist* (June 1970): 1–5.

"reflated" back to the levels of the 1920s, and that reflation should be accomplished by:

(1) the Fed expanding the money supply, and

(2) the Federal government engaging in deficit spending and large-scale public works programs.

In short, during the 1930s, Fisher and the Chicago School were "pre-Keynes Keynesians," and were, for that reason, considered quite radical and socialistic—and with good reason. Like the later Keynesians, the Chicagoans favored a "compensatory" monetary and fiscal policy, though always with greater stress on the monetary arm.

Some might object that Milton Friedman does not believe so much in a manipulative monetary and fiscal policy as in an "automatic" increase by the Federal Reserve at a rate of 3–4 percent per year. But this modification of the older Chicagoans is purely a technical one, stemming from Friedman's realization that day-to-day, short-term manipulations by the Fed will suffer from inevitable time lags, and are therefore bound to aggravate rather than ameliorate the cycle. But we must realize that Friedman's automatic inflationist policy is simply another variant in his pursuit of the same old Fisherine-Chicagoite aim: stabilization of the price level—in this case, stabilization over the long run.

Thus, Milton Friedman is, purely and simply, a statist-inflationist, albeit a more moderate inflationist than most of the Keynesians. But that is small consolation indeed, and hardly qualifies Friedman as a free-market economist in this vital area.

Fisher, Friedman, and the End of the Gold Standard

From his earliest days, Irving Fisher was—properly—considered to be a monetary radical and a statist for his desire to scrap the gold standard. Fisher realized that the gold standard—under which the basic money is a commodity mined on the free market rather than created by government—was incompatible with his overpowering desire to stabilize the price level. Hence, Fisher was one of the first modern economists to call for the abolition of the gold standard and its replacement by fiat money.

Under a fiat system, the currency name—dollar, frank, mark, etc.—becomes the ultimate monetary standard, and absolute control over the supply and use of these units is necessarily vested in the central government. In short, fiat currency is inherently the money of absolute statism. Money is the central commodity, the nerve center, as it were, of the modern market economy, and any system that vests the absolute control of that commodity in the hands of the State is hopelessly incompatible with a free-market economy or, ultimately, with individual liberty itself.

Yet, Milton Friedman is a radical advocate of cutting all current ties, however weak, with gold, and going onto a total and absolute fiat dollar standard, with all control vested in the Federal Reserve System.[16] Of course, Friedman would then advise the Fed to use that absolute power wisely, but no libertarian worth the name can have anything but contempt for the very idea of vesting coercive power in any group and then hoping that such group will not use its power to the utmost. The reasons that Friedman is totally blind to the tyrannical and despotic implications of his fiat money scheme is, once again, the arbitrary Chicagoite separation between the micro and the macro, the vain, chimerical hope that we can have totalitarian control of the macro sphere while the "free market" is preserved in the micro. It should be clear by now that this kind of a truncated, Chicagoite micro-"free market" is "free" only in the most mocking and ironic sense: it is far more the Orwellian "freedom" of "Freedom is Slavery."

A Return to the Gold Standard

There is no question about the fact that the present international monetary system is an irrational and abortive monstrosity, and needs drastic reform. But Friedman's proposed reform, of cutting all ties with gold, would make matters far worse, for it would leave everyone at the complete mercy of his own fiat-issuing state. We need to move precisely in the opposite direction: to an international gold standard that would restore commodity money everywhere and get all the money-manipulating states off the backs of the peoples of the world.

Furthermore, gold, or some other commodity, is vital for providing an international money—a basic money in which all nations can

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[16]See Murray N. Rothbard, *What Has Government Done To Our Money?* (Auburn, Ala.: Ludwig von Mises Institute, 1990).

trade and settle their accounts. The philosophical absurdity of the Friedmanite plan of each government providing its own fiat money, cut loose from all others, can be seen clearly if we consider what would happen if every region, every province, every state, nay every borough, county, town, village, block, house, or individual would issue its own money, and we then had, as Friedman envisions, freely fluctuating exchange rates between all these millions of currencies. The ensuing chaos would stem from the destruction of the very concept of money—the entity that serves as a general medium for all exchanges on the market. Philosophically, Friedmanism would destroy money itself, and reduce us to the chaos and primitivism of the barter system.

One of Friedman's crucial errors in his plan of turning all monetary power over to the State is that he fails to understand that this scheme would be inherently inflationary. For the State would then have in its complete power the issuance of as great a supply of money as it desired. Friedman's advice to restrict this power to an expansion of 3–4 percent per year ignores the crucial fact that any group, coming into the possession of the absolute power to "print money," will tend to . . . print it! Suppose that John Jones is granted by the government the absolute power, the compulsory monopoly, over the printing press, and allowed to issue as much money as he sees fit, and to use it in any way that he sees fit. Isn't it crystal clear that Jones will use this power of legalized counterfeiting to a fare-thee-well, and therefore that his rule over money will tend to be inflationary? In the same way, the State has long arrogated to itself the compulsory monopoly of legalized counterfeiting, and so it has tended to use it: hence, the State is inherently inflationary, as would be any group with the sole power to create money. Friedman's scheme would only intensify that power and that inflation.

The only libertarian solution, in contrast, is to make the State disgorge its hoards of commodity money. Franklin Roosevelt, under cover of a "depression emergency," confiscated all of the gold held by the American people in 1933, and nothing has been said for nearly four decades about giving our gold back. In contrast to Friedman, the genuine libertarian must call upon the government to give the people back their stolen gold, which the government had seized from us in return for its paper dollars.

Neighborhood Effects

Thus, in the two vital macro fields of taxation and money, Milton Friedman's influence has been enormous—far greater than in any other area—and almost uniformly disastrous from the point of view of a genuinely free market. But even on the micro level, where his influence has been smaller and usually more beneficial, Friedman has provided to interventionists a theoretical loophole as wide as a barn door. For Friedman maintains that it is legitimate for the government to interfere with the free market whenever anyone's actions have "neighborhood effect." Thus, if A does something which will benefit B, and B does not have to pay for it, Chicagoites consider this a "defect" in the free market, and it then becomes the task of government to "correct" that defect by taxing B to pay A for this "benefit."

It is for this reason that Friedman endorses government supplying funds for mass education, for example; since the education of kids is supposed to benefit other people, then the government is allegedly justified in taxing these people to pay for these "benefits." (Once again, in this area, Friedman's pernicious influence has been in trying to make an inefficient State operation far more efficient; here he suggests replacing unworkable public schools by public voucher payments to parents—thus leaving intact the whole concept of tax-funds for mass education.)

Apart from the vitally important realm of education, Friedman would, in practice, limit the neighborhood effects argument to such measures as urban parks. Here, Friedman is worried that if the parks were private, someone might enjoy looking at one from afar and not be forced to pay for this psychic benefit. Hence, he advocates public urban parks only. Rural parks, he feels, can be private for they can be secluded enough to force all users to pay for services rendered.

It is small comfort that Friedman himself would confine this neighborhood-effects argument to a few instances, such as education and urban parks. In reality, this argument could be used to justify almost any intervention, and subsidy and tax scheme. I, for example, read Mises's *Human Action*; I therefore imbibe more wisdom and become a better person; by becoming a better person, I benefit my fellow man; yet, hang it, they are not being forced to pay for those benefits! Shouldn't the government tax these people and subsidize me for being so worthy as to read *Human Action*?

Or, to take another example, whether Women's Libbers like it or not, many men obtain a great deal of enjoyment from watching girls in mini-skirts; yet, these men are not paying for this enjoyment. Here is another neighborhood effect remaining uncorrected! Shouldn't the men of this country be taxed in order to subsidize girls to wear mini-skirts?

There is no point in multiplying examples; they proliferate almost endlessly, and expose the total absurdity and the pervasiveness of Chicagoite neighborhood-effect concessions to statism. The only reply that Chicagoites have been able to make to this *reductio ad absurdum* is that they wouldn't carry government intervention that far, though they concede the logic. But why not? By what standard, by what criterion, do they stop at parks and schools? The point is that there is no such criterion, and this only points up the intellectual bankruptcy, the lack of logical rigor, at the core of most current-day economics and social science—Friedmanism included.

The Impact of Friedman

And so, as we examine Milton Friedman's credentials to be the leader of free-market economics, we arrive at the chilling conclusion that it is difficult to consider him a free-market economist at all. Even in the micro sphere, Friedman's theoretical concessions to the egregious ideal of "perfect competition" would permit a great deal of governmental trust-busting, and his neighborhood-effect concession to a government intervention could permit a virtual totalitarian state, even though Friedman illogically confines its application to a few areas. But even here, Friedman uses this argument to justify the State's provision of mass education to everyone.

But it is in the macro sphere, unwisely hived off from the micro by economists who remain after sixty years ignorant of Ludwig von Mises's achievement in integrating them, it is here that Friedman's influence has been at its most baleful. For we find Friedman bearing heavy responsibility both for the withholding tax system and for the disastrous guaranteed annual income looming on the horizon. At the same time, we find Friedman calling for absolute control by the State over the supply of money—a crucial part of the market economy.

Whenever the government has, fitfully and almost by accident, stopped increasing the money supply (as Nixon did for several months in the latter half of 1969), Milton Friedman has been there to raise the banner of inflation once again. And wherever we turn, we find Milton Friedman, proposing not measures on behalf of liberty, not programs to whittle away the Leviathan State, but measures to make the power of that State more efficient, and hence, at bottom, more terrible.

The libertarian movement has coasted far too long on the intellectually lazy path of failing to make distinctions, or failing to discriminate, of failing to make a rigorous search to distinguish truth from error in the views of those who claim to be its members or allies. It is almost as if any passing joker who mumbles a few words about "freedom" is automatically clasped to our bosom as a member of the one, big, libertarian family. As our movement grows in influence, we can no longer afford the luxury of this intellectual sloth. It is high time to identify Milton Friedman for what he really is. It is high time to call a spade a spade, and a statist a statist.

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Paul Samuelson's *Economics*, Ninth Edition

Reviewing another edition of Paul Samuelson's *Economics* is a task as impossible as reviewing in brief the present state of American economics itself. This spectacular best seller in the history of economic textbooks has inspired a flotilla of imitators. A new edition appears every triennium, replete with multi-colors, charts, diagrams, and the latest techniques in professional layout, and surrounded by satellite ships: instructors' manual, student workbook, readings, transparencies, test banks, you name it.

It is no accident that, in every succeeding edition, the colors get gaudier and, more important, the size gets bigger (868 pages in the eighth edition, 917 in the new ninth). For what the hapless undergraduate discovers in Samuelson and his flock of imitators is a vast potpourri (or kitchen midden, depending on one's point of view) of bits and smidgens of technique and of data, none of them integrated into any sort of digestible or comprehensible whole. Samuelson concludes the preface to his new edition by asserting, in his typically breezy style: "My envy goes out to the reader, setting out to explore the exciting world of economics for the first time . . . may I only say, bon appetit!" (p. xii). In contrast, my heart goes out to the poor bewildered undergraduate, confronted with this gigantic stew, ranging from opinionated wisecracks to the Giffen Paradox to marginal productivity analysis to Harrod-Domar-Modigliani growth models to notes on economists past and present to the latest ultrasophistication in reswitching analysis. What in the world can he make of all this? It is no wonder that economics is almost universally the most disliked

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subject in the college curriculum. The undergraduate is presented with no clear and coherent picture, no cogent guidelines on what economics is all about. Instead, beginning by knowing next to nothing about the field, he can only hold on, memorize like mad, and pray for the course to be over and his six credits achieved. Not that the other major texts are much better; Samuelson's *Economics* differs from its rivals largely in being bigger, more indigestible, and filled with the flip and unsupported wisecracks with which Samuelson is wont to dismiss deviant economic views.

Samuelson and most other texts get larger each edition because they are written as compendia of received economic opinion at the time of publication. And so very little gets dropped; as new economic problems are faced in the society, more chapters—more problem areas—get added to the book, whether the new fashion be underdevelopment or unemployment or inflation or the New Left or ecology. Hence, by their very nature, it is almost impossible for these textbooks to lead the profession, or to lead the concerns of society, or, therefore, to prepare the student for the new problems he is bound to face in the world he will enter. Instead, these textbooks are always and necessarily bringing up the rear, adding yet another section or chapter on a "relevant" fashion at the time of revision, only to find the subject old hat shortly after publication. Yet, several more indigestible bits and pieces are added permanently to the stew. How much better it would be to stop trying to touch on every conceivable economic topic and to take the basic essentials of economic theory and develop them carefully and thoroughly (as, for example, Alchian and Allen do in their brilliant *University Economics*, although this too is far above the true level of the basic introductory course).[1]

Before turning to the specifics of the ninth edition, let it be said that, as in the case of the preceding eight, the text suffers from the standard major ills of contemporary American economics: notably the sterile emphasis on the conditions of a static equilibrium which never can (and never should) exist, and the repeated sonorities of the Keynesian model presented without so much as indicating its major flaws and fallacies. Finally, like its predecessors, Samuelson's

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[1]Armen A. Alchian and William R. Allen, *University Economics*, 3rd ed. (Belmont, Calif.: Wadsworth Publishing, 1972).

ninth scarcely equips the reader for facing the real world of ever-accelerating inflation or of the recurring reality of inflationary recession. No cogent explanation of these burgeoning and unwelcome phenomena is offered.

The central feature of Samuelson's new ninth edition, as contrasted to the eighth, is his sincere attempt to dilute the aggressive and monolithic middle-of-the-roadism that marked his previous editions. Here he attempts to introduce his students to other, contrasting approaches to economics: from the Marxists and New Leftists on his left to Milton Friedman and the Chicago school on his right. Letting the nation's undergraduates know of other serious forms of economics than his own centrism is, of course, all to the good, and will hopefully instruct the student that there is more to economics than one man's (or even the majority's) crotchets.

Much needs to be done, for we still learn of critical points of view not as integral to the body of economics, but as just a few more indigestible pieces to add to our ever more impossible stew. Take the way in which Samuelson handles the numerous and cogent critiques of the validity of the GNP as any sort of welfare criterion. GNP and its allied concepts have been central to Samuelson's brand of Keynesian economics since the inception of his text in 1948. After nearly four decades of deadly criticism from both Right and Left, Samuelson is compelled to do something to acknowledge and even incorporate these criticisms. Instead of gaining some much-needed humility, and acknowledging the GNP and allied concepts are flawed to the very core (as he would do, for example, if he took to heart the lessons of Alex Rubner and Oskar Morgenstern), Samuelson simply and aggressively keeps GNP and tacks on one more flawed and unmeasurable concept, "net economic welfare," taken from Nordhaus and Tobin. Instead of discarding or at least downgrading GNP, Samuelson thus simply adds an NFW which tries vainly, for example, to measure such unmeasurable concepts as leisure and the "disamenities" of life (pp. 195–97).[2]

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[2]The Nordhaus-Tobin discussion is in William Nordhaus and James Tobin, "Is Growth Obsolete?" *Fifteenth Anniversary Colloquium V* (New York: National Bureau of Economic Research, Columbia University Press, 1972). Rubner's critique of GNP is in Alex Rubner, *Three Sacred Cows of*

In his new discussion of "sex discrimination" in the labor market, Samuelson does even more poorly, for he naïvely and uncritically accepts the simplistic charges of the women's lib movement that the lower earnings of women merely reflect discrimination and "exploitation" by employers. At some points, Samuelson's rhetoric is scarcely less hysterical than that of the embattled feminists: "Who is exploited? Women, of course. Who is the exploiter? In a sense, men, who are climbing, so to speak, on the shoulders of the downtrodden women" (p. 798). There is no consideration by Samuelson of the alternative possibility that female marginal productivity is lower than that of men. If that were not the case, then employers could reap extra profits by hiring only women at the lower wage rates. Why do they not do so? Nor does Samuelson mention the important empirical findings of Victor Fuchs that the earnings of women in self-employed occupations are relatively far lower, compared to men, than in employee occupations, which cuts directly against the idea of employer discrimination against females.[3]

In his attempt to give more weight to the views of the free-market economists to his right, Samuelson falls into the egregious error of including Friedrich A. Hayek among "Chicago School libertarians" and then compounds and reverses the error by including Frank Knight in the "Austrian School" (a term he leaves unexplained). Clearly, if Samuelson had granted to the libertarians a fraction of the care he has given to distinguishing between various brands and offshoots of Marxism, he would have taken the time to distinguish between these two very different variants of free-market economics.

In other areas, Samuelson's ninth edition merely repeats the errors and fallacies of the eighth. Thus, on his final page, he tries to refute Hayek's brilliant and complex analysis and warning in *The Road to Serfdom* by simplifying it beyond recognition and then dismissing it in a

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Economics (New York: Barnes and Noble, 1970), pt. 1. Also see Oskar Morgenstern, *On the Accuracy of Economic Observations*, 2nd rev. ed. (Princeton, N.J.: Princeton University Press, 1963).

[3]Victor R. Fuchs, "Difference in Hourly Earnings Between Men and Women," *Monthly Labor Review* (May 1971): 9–15. For an introductory textbook which does incorporate these finds, see Roger Leroy Miller, *Economics* (San Francisco: Canfield Press, 1973).

totally spurious "regression" diagram between "economic freedom" and "political freedom." Apart from the absurdity of this sort of regression, and the impossibility of "measuring" such freedoms, what can one think of a regression diagram that grants Hitler's Third Reich virtually the same degree of economic freedom as the United States in 1973? Does Samuelson know that the Third Reich was a collectivized and planned economy? One wonders, too, why the Communist countries rate no inclusion in this diagram at all. Perhaps a glimmering of doubt has invaded the small world in which Samuelson can call for ever bigger government in the economic sphere while expecting to retain full civil liberties. For he has omitted from the current edition (p. 885) the eighth edition's note to the freedom-regression diagram (p. 834): "Since the 1953 witchhunting days of Senator Joseph McCarthy, political freedoms of American citizens have improved despite increased economic role of government." Perhaps Professor Samuelson had a prophetic inkling of the soon-to-be-revealed horrors of the Watergate!

Another unfortunate repetition of error is Samuelson's failure to devote more attention to the business cycle and theories explaining this phenomenon. Now that the business cycle has been shown to be still with us, we can no longer settle for the glib Keynesian assurance that the cycle is a thing of the past, abolished by fiscal policy, even if we add on Friedmanian monetarism as an extra tool in the planners' arsenal. Hence the inadequacy of the brief and misleading footnote taken from previous editions which sums up the various cycle theories. The Austrian theory is almost scandalously treated as follows (in its entirety): "the over-investment theory . . . claims too much rather than too little investment causes recessions (Hayek, Mises, et al.)" (p. 256*n*). Here it is at least Samuelson's responsibility to explain the theory at some length, and to point out (a) that the "over-investment" is caused by continuous monetary inflation by the banks, and (b) that the result of the bank credit expansion is overinvestment in the "higher orders" of capital goods, matched by underinvestment in the consumer-goods industries.[4]

[4]We might mention here the *bizarrerie* of Samuelson's including in his ninth edition a discussion of the highly advanced and sophisticated "reswitching" theory of capital in an elementary textbook (pp. 615–16).

Moreover, and still without presenting any evidence, Samuelson repeats the myth of ever-widening income differentials between the advanced and the underdeveloped countries. There is no hint of recognition by Samuelson of the subtle and sophisticated work that Peter T. Bauer has done over many years in demonstrating the mythology of this much-repeated assertion.[5]

Finally, Samuelson's eagerness to include every new development in the profession or in the economy has unaccountably overlooked what is perhaps the most important development in the economics profession in the past decade: the Coase-Demsetz analysis of the importance of property rights and of transaction costs and their use of property-rights concepts to analyze all the various problems of external economies and costs. The fact that there is not a single mention of transaction costs or of property-rights analysis in Samuelson demonstrates that perhaps our chef of the economic mulligan stew has a blind eye to developments that occur among his free-market colleagues.

Samuelson's ninth, in short, is a considerable improvement over previous editions. There is at least an attempt, however feeble, to pay attention to different points of views in economics. But Samuelson has a long way to go, and not only in including important theoretic concepts and new empirical research. In what future edition will he rethink the central idea of the swollen and elephantine grab-bag textbook, ever adding bits and pieces of data and technique, and never discarding or concentrating on the fundamentals of economic analysis? And in what future edition will he seriously call into question, not such fashionable "relevant" worries as the "quality of life" or ecology or alienation-and-the-early Marx, but the very heart of contemporary economics: static equilibrium and the Keynesian model? When indeed?

Apparently, the inclusion of an alleged refutation of orthodox Austrian capital theory was too much of a temptation as a stick with which to beat free-market economics for Samuelson to resist.

[5]Thus, see Peter T. Bauer, *Dissent on Development: Studies and Debates in Development Economics* (Cambridge, Mass.: Harvard University Press, 1972), pp. 49–68.

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Heilbroner's *Economic Means and Social Ends*

All symposia necessarily suffer from dispersion and lack of focus, but often they are redeemed by being permeated by an overarching and significant central theme. This symposium suffers even more than others on two vital counts: its vagueness and absence of clear focus, and the banality and lack of importance of its central theme.

For these are papers presented in two two-day symposia held in the spring of 1968 at the New School for Social Research, all dealing with the allegedly new science of "Political Economics" developed by Adolph Lowe, a professor emeritus at the New School. The entire work is suffused by a reverential "old boy" atmosphere that turns the papers into a celebratory exercise for the existence and the output of Professor Lowe; as a result, even the papers which could have been more searching and critical take on a muted and suffused tone, as if not to spoil the atmosphere of laudation. The disunity of the work is intensified by the fact that half the contributors are philosophers and the other half economists; the philosophers display minimal knowledge of economics and most of the economists ignore the philosophical problems involved. Professor Lowe begins the work by summarizing his position and then concludes with a reply to his commentators.

The abiding curiosity of the book is what Professor Lowe has accomplished to merit this extensive treatment. For his "new science

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of political economics" is little more than a cloudy and abstruse call for an instrumental form of socialism, and there is nothing here that has not been presented far more clearly and trenchantly by Marx, Veblen, and countless writers in the socialist literature.

To Professor Lowe, the great flaw of the free-market economy is that it is "disorderly" and unpredictable, presumably because every individual is free to pursue his own goals in his own way. It is the necessary task of government, then, guided, to be sure, by Lowe's "political economists," to coerce the citizenry into acting in a "predictable" fashion, and to impose "order" upon the economy in the service of what Lowe concedes are the purely arbitrary goals of the political economists. In short, the goals and ends decided upon by the economists-rulers, no matter how arbitrary they may be, are to be imposed upon the rest of society by dictatorial fiat and by the coercive arm of the State. In common with most would-be dictators throughout history, of course, Professor Lowe would like as many people as possible to adopt his goals themselves in a voluntary or at least quasi-voluntary manner. Hence his eagerness for massive propaganda efforts by the government and its political economists to "educate" the citizenry to support the goals of their rulers. But should such "manipulation"—a term conceded by Professor Lowe—fail, as in many cases it must, then the government must move on to frankly coercive measures. As Professor Lowe puts it, "So long as they have not conquered public opinion, such goals can be accomplished only if the sponsoring minority [his "political economists"] succeeds in imposing its will on an antagonistic majority." Of course, this elitist coercion is purely for the "good" of the coerced: "an enlightened minority perceives as a long-term necessity what to a majority, blinded by short-term concerns, appears as a is violation of its interests" (pp. 191–92).

Ever since the days of the classical economists, the advocates of dictatorial statism have run up against the rock of economic law. This is not simply because the bulk of economists have been committed to economic freedom and the decentralized decision-making of the market, but because economists have shown that government interventionism and full-scale socialist planning simply do not work, that is, do not achieve the stated goals of the rulers themselves. Hence the necessity for statists to deny the existence of economic law. Professor Lowe continues in this tradition. Hence his need to create a methodology of economics which rejects the two major methodologies of modern economics: the "praxeology" of the Austrian school, and the positivism of the currently dominant Anglo-American orthodoxy, both of which arrive in variant ways at a structure of economic law. Lowe's "instrumental" methodology simply denies economics and relies solely on (a) arbitrary goals imposed by the political economists and other rulers; and (b) on "technology," which offers a purely technological guide to the achievement of these goals. Hence we are back in a form of Veblenian "technocracy," with economics discarded altogether. And yet, pure technology can offer no guide to the opportunity costs that must be weighed in any sort of rational allocation of economic resources; for this, a relatively free price system must be allowed to function along with its corollary of private ownership and freedom of exchange of ownership titles to resources. There is no hint of recognition by Professor Lowe that the socialist countries of Eastern Europe, led by Yugoslavia, have found it necessary to abandon socialist central planning and to move rapidly in the direction of a free-market economy, with its price system, decentralized decision-making and planning, and profit-and-loss tests for the allocation of resources.

Professor Lowe's political economics is of a piece with an unfortunate penchant of intellectuals since the days of Plato: to impose their own arbitrary and static "order" upon the rest of society, to freeze and annul change by their coercive fiat and to exert power over the rest of mankind. As a corollary, the structure of reality as embodied in economic law must be ignored and denied in order to make the vain attempt to enforce the whims and wishes of the intellectual upon the rest of mankind. The structure of reality must be ignored in order to try to impose the whims of the intellectual upon the world. In this attempt, the intellectual and the political ruler are closely allied. As the economist Ludwig von Mises has stated:

> It is impossible to understand the history of economic thought if one does not pay attention to the fact that economics as such is a challenge to the conceit of those in power. . . . The laws of the universe about which physics, biology, and praxeology [economics] provide knowledge are independent of the human will, they are primary ontological facts rigidly restricting man's power to act. . . . Only the insane venture to disregard physical and biological laws. But it is quite common to disdain economic laws. Rulers do not

> like to admit that their power is restricted by any laws other than those of physics and biology. They never ascribe their failures and frustrations to the violation of economic law.[1]

Apart from the central issue of Adolph Lowe's economics, there are important tangential questions which the book raises, though usually inadvertently. There is, for example, Professor Lowe's passion for "predictability," a passion which leads him to advocate governmental coercion to *make* people act in predictable ways. Much of this stems from a grave misunderstanding that economists and other social scientists have fallen on the notion that "science means prediction." For the "prediction" that the physical scientist makes in enunciating his physical laws is totally different from the "prediction" that economists have been indulging in. The scientist's predictions are of the form "If A, then B"; if copper and sulfur are mixed in certain proportions, they will yield copper sulfate. But the scientist is not a soothsayer engaged in "predicting" or foretelling the future: he never presumes to predict *how many* of his fellows, for example, will be making copper sulfate in their laboratories over the next year. And yet this is precisely the totally unscientific trap that economists have fallen into; instead of confining themselves to the scientific "prediction," "if A, then B," they are presuming to forecast the future. It is no wonder that, as Victor Zarnowitz and others have shown, the record of econometric forecasting, despite the use of the most sophisticated models and computers, has been so dismal—indeed, has been worse than simple extrapolation of trend, of even such a relatively simple forecast as predicting GNP for the next quarter. So long as men have free will and change their values and choices, and so long as knowledge changes and accumulates, scientific forecasting of the future will be impossible. Professor Lowe, entranced by the erroneous view of predictability, rightly sees that econometric forecasting has been a failure; but instead of concluding from this that economic science should be recast into a qualitative and "praxeological" mold, he presumes to abandon economics altogether and to turn to the secular arm to *force* people to act in predictable ways.

John Jewkes has aptly written that "the economist's claim to predictive authority must be false in that it leads to a palpable absurdity. If the economic future can, indeed, be described, why not also the

[1]Ludwig von Mises, *Human Action* (New Haven, Conn.: Yale University Press, 1949), pp. 67, 755–56.

scientific future, the political future, the social future, the future in each and every sense? Why should we not be able to plumb the mysteries of future time?"[2] And Professor Peter T. Bauer has written wittily and trenchantly comparing the contemporary mania for forecasting with the upsurge in credulity and belief in oracles and soothsayers during the years of decline of the Roman Empire.[3]

There is one group of people in society who are skilled in forecasting aspects of the future, and they do it far better than economists or politicians. These are the entrepreneurs and speculators: the entrepreneur who estimates his future costs and revenues; the speculator who tries to estimate the future course of stock or commodity prices. For forecasting is not and cannot be a science; at best it is an art, and the best such "artists" are those who have a "feel" for the conditions of their particular markets. There is a process of natural selection on the market which brings the better forecasters to the fore and discourages the poorer ones: the making of profits and capital gains and the suffering of losses. The poor forecaster on the commodity or stock markets will not last long in his chosen occupation. Yet it is precisely these superior forecasters on the market whom Professor Lowe finds to be harbingers of "disorder."

There is another fundamental flaw in Lowe's turning to government to insure predictability. What makes him believe that the actions of *government* are more predictable than the actions of individuals on the market! The latter are at least disciplined by the test of profit and loss. The former have no discipline exerted upon them whatsoever. Indeed, ever since the vagaries and whims of statutory law and executive edict have replaced the far more predictable rules of the common law, government action has been notoriously fickle and free-wheeling, and hence particularly unpredictable. In the jostle and bustle of ever-changing pressures and political influence-seeking by organized pressure groups, there is not even a profit-and-loss restraint to keep government within definable bounds. (The American Constitution has long ceased to serve as any sort of definable limit, particularly on economic questions.) Furthermore, as far as

[2]John Jewkes, "The Economist and Economic Change," in *Economics and Public Policy* (Washington, D.C.: Brookings Institute, 1955), p. 83.

[3]Peter T. Bauer, *Economic Analysis and Policy in Underdeveloped Countries* (Raleigh, N.C.: Duke University Press, 1957), p. 30.

forecasting mania goes, the American government has had a notoriously poor record even in predicting its *own* expenditures for the next fiscal year, let alone the remainder of the economic system.

Finally, on what basis does Professor Lowe hold it self-evidently desirable to have complete predictability? Such predictability would only be possible if men were will-less, robots and automatons; since they are not, their actions will ever be gloriously free from perfect predictability. Would we really have a better world if they were reduced to automatons, even if this anti-human act could be accomplished? But of course, as in all variants of philosophical determinism, the determinist himself and his colleagues have prepared for themselves an implicit escape valve. *Other* people will be coerced and rendered predictable; *other* people will be manipulated or forced into being automatons; while Professor Lowe and his political-economist colleagues will have the free will to impose their own conception of economic and social goals.

Another important question raised, but hardly satisfactorily treated by this book, is the entire problem of the relation of the scientific economist to public policy. On what basis can the scientific economist advocate goals, or indeed, endorse any public policy whatever? None of the authors comes to grips with this question. Most, such as Professor Lowe and his self-proclaimed follower in economics, Carl Kaysen, simply and lightheartedly assert that the economist must be an activist in pushing for, advocating and even enforcing his own goals and his own political prescriptions. Even Fritz Machlup, of all the contributors the only one to point out, albeit mildly and tangentially, the authoritarian implications of Lowe's position, concedes that the economist must advocate goals and policies. Machlup, for example, scorns the "purists among us [who] may cry, 'Unclean! Unclean!' whenever they see a piece of welfare analysis" (p. 124). But this misses the vital point. No "purist," and certainly not the present reviewer, would try to bar any economist from ever advocating any public policy. But what he *would say*, and insist upon strenuously, is that it is totally illegitimate for economists, including Lowe, the other contributors and the great bulk of the economics profession, to advocate any public policy or to express any value judgments whatever in an *ad hoc*, arbitrary and offhand manner. To put it more explicitly, if an economist offers a value judgment or advocates policy, it is incumbent upon him to offer, stand upon and defend an *ethical* system from which the judgment or policy can be deduced. Anything less is arbitrary, unscientific and illegitimate, and simply amounts to the arbitrary imposition of an economist's personal set of values upon society. In that case, the economist simply becomes a propagandist, not of a defensible ethical system, but of his own unsupported caprice. (This position, of course, itself stems from an ethical system which condemns capricious social judgments.)

Let us illustrate by postulating a "political economist" with a very different set of values from those held by Professor Lowe. He lives in an unspecified underdeveloped country and he sees that a certain ethnic group, say the Lebanese, have risen to important entrepreneurial positions in that economy. In the course of his discussion, he offhandedly asserts that it is necessary to place special taxes, burdens, and so on, on the Lebanese in order to reduce their weight in the economy and in society. And then he goes on to other matters. Here he has, as a good "political economist" or "welfare economist," imposed his own set of goals, *ad hoc* and unanalyzed, as if they were self-evident and needed no groundwork in an ethical system. In this case we would surely respond that our economist's value lucubrations were not enough: that he has the responsibility of offering a defensible ethical system which would support the placing of special burdens upon the Lebanese ethnic group. But if that is true in this case, it is true in all; whenever an economist ventures into the realm of political ethics, he must support his viewpoint coherently and systematically. Yet this procedure is all too rare among economists today.

Just a few more *curiosa* need to be mentioned. The extent of Professor Lowe's grasp of elementary economics can be gauged from one of his examples of the alleged growing divergence of economic behavior from classical maxims: "nowadays, rising prices are often accompanied by rising demand and falling prices, rather than by the 'correct' response of falling demand and rising prices" (p. 13). Charitably setting aside the "falling prices" phrase as a typographical error, we are still forced to the conclusion that Professor Lowe cannot distinguish between shifts in the demand curve and movement along the curve, the *pons asinorum* of freshman economics.

Then there is the anomaly of Professor Gurwitsch's contribution. Gurwitsch, a philosopher of the New School, restates Lowe's position with far greater clarity than Lowe himself is able to muster. But he does so while claiming to base his position on the work of the late

Alfred Schütz, the phenomenological sociologist at the New School. Yet there is not a hint in Gurwitsch's article of the fact, evident in Schütz's brilliant *Phenomenology of the Social World*[4] of Schütz's closeness to the methodological and sociological views of Ludwig von Mises, the founder of praxeological economics and champion of *laissez-faire*. Mises's views are at the polar opposite from those of Adolph Lowe, and certainly some attempt should have been made by Gurwitsch to clear up this anomaly.

Finally, there is the contribution of economist Carl Kaysen. Remarkably, Lowe embraces Kaysen's article even though Kaysen makes not a single reference to the various methodological issues with which Lowe or the other commentators are concerned. Clearly, the affinity is simply ideological, for Kaysen's essay is essentially a list of the government controls that Kaysen would like to see placed upon the economy. Perhaps the most remarkable is Kaysen's willingness to embrace a policy of extensive monetary and fiscal inflation coupled with direct price and wage controls "to repress inflation," and to do this *solely* to reduce negro unemployment to zero. Apart from the questionable ethics of imposing meat-axe burdens on the bulk of the population in order to benefit a minority, there is not a hint in Kaysen of even the possibility of arriving at the same goal by what is, at the very least, the more efficient approach of lowering or eliminating minimum wage rates, union restrictions or welfare payments.

There is no more apt conclusion to a review of this book than to repeat the quote from Frank H. Knight which Fritz Machlup puts into a footnote in his contribution:

> In the field of social policy, the pernicious notion of instrumentalism . . . is actually one of the most serious of the sources of danger which threaten destruction to the values of what we have called civilization. Any such conception as social engineering or social technology has meaning only in relation to the activities of a super-dictatorship, a government which would own as well as rule society at large, and would use it for the purposes of the governors. (p. 128*n*)

[4]Alfred Schütz, *Phenomenology of the Social World* (Evanston, Ill.: Northwestern University Press, 1967).

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Buchanan and Tullock's *The Calculus of Consent*

I am so out of sympathy with James M. Buchanan and Gordon Tullock's *The Calculus of Consent* that I don't think a particularly detailed critique to send to them would be worthwhile. I recognize that there are some merits to the piece: a searching for methodological individualism in political science, an emphasis upon unanimity rather than majority rule, and a harking back to the constitutional system of 1900 as better than the situation today. But these merits are, I believe, more *ad hoc* than integral to the main body of work. In considering the work as a whole, they are far overshadowed by the numerous flaws and fallacies.

In the first place, their repeated references to "unanimity" are, at first, appealing, but they are highly misleading. A "social contract" theory of government, as you know, can be used in two different ways, and this difference is extremely important: it can be used to set up an *ideal* toward which the government should be transformed (essentially the view of John Locke), or it can be used to place a stamp of approval on all, or most, of the actions of the *existing* government (for example, Rousseau). Thus, the theory of the divine right of kings began as a *check* on government, as an order to the King to stay within divinely-commanded laws; it was transformed, by the State, into a divine stamp of approval for anything the King might decide to do. While there are elements of both in Buchanan and Tullock, the major emphasis of the "unanimity rule" is *not* so

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Excerpted from a letter to Dr. Ivan R. Bierly of the William Volker Fund, August 17, 1960; James M. Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962). Comments refer to a manuscript version of the book.

much to set up a unanimity ideal, as to put a stamp of approval on existing government actions as being "really" backed by unanimous consent. I have noted this before in Buchanan's writings.

How is this done? In many ways, some of which are so involved in their transparent rationalizations as to be almost absurd. The basic way is to set up a dichotomy between "constitutional decisions" and concrete decisions of government policy. Buchanan and Tullock admit that concrete decisions might represent conflict: A and B winning out over, and even at the expense of, C. But "constitutionally," which is a term that they use quite vaguely but which apparently means the rules for government decision-making, they assume that these rules are somehow "unanimously" agreed to, and therefore that, in a sense, the concrete political decisions are also unanimous. Thus, the unanimity rule, seemingly libertarian, actually turns out to be more of a fallacious support for the *status quo*—whatever the *status quo* happens to be—than a plea for libertarian principle.

Why all of us are supposed to be behind the constitutional decisions, Buchanan and Tullock do not really support. They say (as Buchanan did in his journal article last year) that a thief is *really* for a law against stealing so as to keep his own property, so that it can be said that even a thief in a way approves of his own punishment. I think this is absurd; a professional thief is clearly *opposed* to laws against stealing (it is a rule of honor among professional criminals not to run to the police for help—and also a wise precaution for them). How did Buchanan and Tullock manage to get into this trap? By blithely assuming that when the "constitution" is being considered, no one knows whether or not he will be able to benefit by the various rules in specific situations, so it is to everyone's self-interest to have rules, as it were, in the general interest. Now this appears to me to be completely insupportable; people do have certain interests, and they will be able to gauge to what extent a rule will benefit or not benefit them. (This is especially true because Buchanan and Tullock think of the "constitution" as continuing, rather than as the original writing.) The professional thief knows he is a professional thief, and therefore that the weakening of laws against stealing, or constitutional provisions against stealing, will benefit him, and so on.

Further, by unanimity Buchanan and Tullock by no means always refer to real unanimity; instead, they speak of "relative unanimity" or "80 percent unanimity," and so on. In short, when the chips are down, they are willing to waive unanimity in order that the "costs of decision" for the group or society be minimized. "Relative unanimity" is obviously a misleading use of semantics.

In short, despite a lot of talk about unanimity being called for, the upshot of the discussion is that (a) unanimity is weakened by numerous qualifications and circumlocutions—and that (b) much of the existing structure of government is endorsed as being "really" unanimity! This, of course, is worse than simply adhering to majority rule, and comes perilously close to the "we owe it to ourselves," "we are the government" position of the Left.

The worst example of this, including the definite tendency to rationalize the existing situation as reflecting unanimity, is the concept of "income insurance" to justify actions of government that "redistribute" income. Now it is obvious that when government takes from A and deliberately gives to B, this can hardly be called a gesture of unanimity, or people voluntarily banding together to purchase a service from government. But Buchanan and Tullock try to say this, by asserting that the wealthy *really* favor being taxed more than the poor, because they are taking out "income insurance," knowing that when they will be poor, the government, like an insurance company, will help them. And, in another place, they say that people really want to be coerced so long as they are all coerced, so that, everybody is really *not* being coerced. Not only do I consider all this nonsense, but it is dangerous nonsense as well, because it provides new support for the idea that anything that the State does, no matter how blatantly coercive, is "really" backed by everyone.

The placing of the stamp of approval on the State as being really unanimous, furthermore, permeates the entire analysis of this book. For the whole point of the book, the "new contribution," is that Buchanan and Tullock treat the State as just another service agency, basically voluntary, supplying "collective goods" to everyone, minimizing "external costs" when it can do so, and so on. The State is assimilated into the rubric of just another voluntary agency (albeit with complications), and each individual therefore decides on his value scale how much to allocate to private agencies and how much to government. This, I say, is the nub of the entire analysis of the book, and I think it is utterly and absolutely wrong. A significant quote from Buchanan and Tullock will point this up:

> We view collective decisionmaking, collective action, as a form of human activity through which mutual gains are made possible. Thus, in our conception, collective activity, like market activity, is a genuinely cooperative gain. By contrast, much of orthodox political thought seems to be based on the view that the collective choice process reflects a partisan struggle in which the beneficiaries secure gains solely at the expense of the losers.

I think it quite evident that "orthodox political theory" is infinitely superior to the construction of Buchanan and Tullock, and that even though on concrete questions, Buchanan and Tullock will want to reduce to some extent the current level of government operations, the impact of their analysis—of the book itself—will be much more to place a stamp of approval on State action which even "orthodox theory" hadn't placed upon it.

The nub of the distinction between State and market is that, on the market, all parties gain and benefit from market actions, whereas, in State action, the gains of one group can only be *at the expense of* others. Buchanan and Tullock's concept would obliterate the most vital distinction between State and market activity.

Furthermore, Buchanan and Tullock are considerably inferior to the "orthodox" New Welfare Economists, who at least formally recognize, even though they try to get around it, that there has to be unanimity for them to make "scientific" statements of whether society is better off, without introducing their own ethical judgments. (The New Welfare Economists, following Pareto, have in this sense always paid formal obeisance to the unanimity principle.) But Buchanan and Tullock, believing that State action is, on the whole, "really unanimous," believe that they can go much further in making "scientific" pronouncements without bringing in their own value-judgments, and thus they sin more than the usual "welfare economists" in smuggling in their own ethical judgments as scientific statements. This is particularly true in their grandiose conception of how "social costs," where they proclaim that individuals all decide on the exact proportion of government activity in regard to which they can minimize "social costs"; but how can "social costs" be even discussed when some people are gaining *at the expense* of others? To say, for example, that it will lower "social costs" (and therefore, for some reason, it will be good) if the few holdouts in a community who don't want to build a road be forced to pay in taxes for the road, is a fallacious conception—although this is involved in the whole analytic structure of Buchanan and Tullock. For it will undoubtedly minimize the costs of the impatient people who want to get on with the job without "obstruction"; on the other hand, it will greatly *raise* the "costs" of those who staunchly oppose the road and do not wish to be forced to pay for it. Why is the former, and not the latter, "society"? The upshot is, that despite much talk by Buchanan and Tullock of their staunch individualism, especially methodological individualism, they are not consistent individualists at all. They smuggle in, through the back door, societarian and organicist conceptions, namely, in their discussions of social costs.

There are also certain grave epistemological flaws in the book. For one thing, Buchanan and Tullock are, methodologically, confirmed positivists—which is one reason why their theoretical structure is so slipshod. It is bound to be slipshod when their methodological doctrine is that assumptions don't have to be true in order to work, that theory is arrived at by "testing hypotheses" against empirical fact, and all the rest of the positivist trappings which apply the methodology of physics to the sciences of human action.

And second—what is really a corollary—is their misapprehension of what political theory is all about. In modern times, political theory has abandoned *political philosophy*: that discipline that deals with the problem of the nature of the State, what the State should and should not do, and so on. (It has abandoned political philosophy because it has given up the idea that there is a rational discipline of ethics, of which political philosophy is, in a sense, a subdivision.)

Hence, they want to construct a value-free political theory. But while such a theory is important and meaningful in economics, where the theory is based on the fact that people use means to achieve ends—it is empty and sterile in *political theory*. For, after all, politics is a matter of concrete decisions, which in contrast to everyday decisions of consumers and business firms, should be based on general principles. Give up the idea that there *are* such principles—that is, give up political philosophy—and you are left adrift with no rudder, and no genuine political theory. This is what has happened; and we have been left with "political science," with all the positivist trappings, the value-free "models," the quasi-mathematics, the jargon, and so on. Buchanan and Tullock are in this sterile "political science" tradition. But in a sense they carry this unfortunate modern tendency much further. For by blithely assuming that there is no real difference between the State and private institutions and actions, by assimilating government to private actions, they have really become "political philosophers"—and very bad ones. And from this stems their treatment of *political* action as if it were just another good or service like beans and apples, and which is simply valued, like beans and apples, on our value-scales. This "economic" approach to politics, far from the great new advance they think it is, as far as I am concerned, is the death knell of all genuine political philosophy.

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