The Biggest Myth about Money

By Hans Sennholz

Many financial advisers are sounding the alarm: "The forces of deflation are gathering strength and threatening to take over. The stock market is pointing the way and the economy is following." Some even are seeing signs of impending calamity: "The United States is staring into the same deflationary abyss that has swallowed Japan. Debt is becoming back-breaking and liquidity is drying up. Debt defaults are soaring and forced asset sales are exacerbating the decline." Many media reporters are echoing this reaction and attitude.

Deflation, according to these spokesmen of popular economics, is a decline in the prices of goods and services, the reverse of inflation. Both give rise to opposite effects: inflation is said to stimulate output and employment; deflation always affects them negatively. Indeed, popular economics considers deflation to be one of the most dreaded evils in the world today.

Popular economics is the offspring of genetically dissimilar notions, theories, concerns, and interests. It may spring from old economic theories that are popular and pleasing although misleading and erroneous. There are Keynesian doctrines that explain depressions as "gaps" between aggregate production and spending and, therefore, in order to fill the gaps, promote programs of government spending on public works. There are old exploitation doctrines which breed employer-worker confrontations and, hence, prevent efficient market adjustments.

There is an army of civil servants who never tire of espousing and promoting popular economics because it assigns important economic functions to them. There are countless businessmen who readily embrace fashionable economics because it generally favors government regulation which, in turn, tends to reduce the pressures of competition. And finally, popular notions and doctrines please many people because they offer colorful descriptions rather than difficult explanations of causal relations.

Economists view inflation and deflation in a different light. They search for the very causes of rising or falling prices and, having ascertained the origin, know how to avoid the evils. They need not look far for the very mainspring of inflation: the increase in the stock of money by the monetary authority, the Federal Reserve System. The System sets the pace by providing legal-tender money; commercial banks and other financial institutions then add their fiduciary money and credit, always keeping an eye on the authority. The people offer or bid for money, which affects its purchasing power in the same way as it influences the mutual exchange ratios of other goods. In short, demand and supply determine its exchange value.

While the stock of money tends to increase continually at the discretion of the monetary authority, the demand for money reacts rather slowly to changes. It may vary radically, however, when people regard their economic situation with fear and, therefore, significantly change their money holdings. The fear of ever more inflation and monetary depreciation may give rise to a "flight from money," which may produce double-digit or even triple-digit inflation. The fear of a looming disaster or depression, on the other hand, may induce people to cling to their money, which increases the demand for money, raises its value, and thereby lowers goods prices. In the language of popular economics, their reluctance to spend money may lead to deflation.

At this time in our "bubble" economy the fear of stagnation and decline is increasing the demand for money and exerting a powerful downward pressure on goods prices. It is rendering the expansion efforts by the Fed and the U.S. Congress rather ineffective. In terms of popular economics, uncertainty and fear are frustrating Fed efforts to "jump-start" the economy. The Fed is "pushing on a string." It exerts ample control over banking and credit institutions through a number of regulatory instruments such as setting reserve requirements for member banks, determining the rate of discounts and advances, and engaging in open market operations.

But the Fed has little control over the actions and reactions of millions of dollar holders throughout the world. Their freedom to offer or bid for U.S. dollars is the ultimate variable in monetary management and control. To the Fed it is an irritating and exasperating restraint of its power over the people's money.

The painful pressures of economic stagnation despite strenuous Fed efforts to inflate the stock of money must be seen in this light. The weight is keenly felt in the world of capital goods where businessmen must make difficult employment decisions. They often are the primary victims, easily misled by the Fed's recurrent policy of stimulation through "easy money" and "low-interest" credit. Misinformed and misdirected they embark upon costly projects and ventures which, in a fever of soaring prices and costs, are found to be costly mistakes inflicting painful losses. In the end, loss-inflicting projects need to be abandoned and unprofitable labor be discharged. Businessmen are forced to hold on to their money, which may develop the symptoms of deflation. Consumers are likely to follow suit.

Economists nevertheless refuse to be alarmed by fearful prognoses of deflation. They see instead a number of glaring inflation symptoms, such as rising commodity and energy prices, that point to more inflation to come. Analysts focus on U.S. fiscal and monetary policies that are highly inflationary and soon may erase the deflation symptoms. They always look upon inflation as the root cause of many economic evils, especially the cyclical instability. Deflation, in their view, is merely an inevitable phase of a business cycle that is engendered by inflationary policies; it is the final phase, painful but wholesome, as it forces businessmen to readjust to the demands of the market.

The deflation symptoms may soon give way to the forces of inflation. Massive imports of all kinds of goods still are keeping a lid on consumer prices. In 2002 Americans imported about $500 billion more than they exported, that is, they consumed more than they produced, financing the deficits with U.S. dollars, most of which remained abroad or were invested in U.S. government obligations. The trade deficits and foreign dollar holdings exert powerful exchange-rate pressures on the dollar which in recent months already lost more than 20 percent versus the euro and may lose more in the future. Further U.S. dollar losses are bound to reduce American imports, promote exports, and consequently raise goods prices. In short, a declining dollar in foreign exchange markets may soon rekindle the inflation fever.

The federal government itself faces budget deficits as far as the eye can see. Tax revenues are down and expenditures, magnified by the war in Iraq, are out of sight. Moreover, Congress may cut taxes, guided by the supply-side assumption that tax cuts promote economic expansion and thereby generate additional tax revenues which may offset and cover the earlier revenue losses. Unfortunately, the budget deficits do not abide by supply-side notions. They surely would raise interest rates and depress business investment, if they would consume actual savings.

But the Fed continues to collaborate by creating new funds and reserves which enable commercial banks to offer their fiduciary credits. Interest rates may remain steady or even decline, but they no longer signal the true state of the capital market; they deceive and mislead investors, cause new distortions and malinvestments, and prime the markets for more inflation to come.

America's engine of inflation, the Federal Reserve System, hardly ever slows down in its portentous endeavors. As of March 19, its present data, total Fed credit rose $67.6 billion, or 9.6 percent, since a year ago. The broadest measure of money supply, M3, which includes currency in circulation, checking accounts balances, savings accounts and time deposits such as CDs and money market fund balances held by institutions, may explain the Fed's fear of deflation—it is up only $473 billion, or just 5.8 percent. And producer prices have risen only 3.6 percent since a year ago and consumer prices just 3 percent. The 9.6 percent Fed credit expansion is the starter fluid that is to jump-start the American economy.

There is no deflation abyss that may swallow the economy. There never was a bottomless pit which swallowed Japan or any other economy. But there are abysses that swallow countries the governments of which conduct abysmal policies. Political blunders and economic follies are depressing the Japanese economy.

Ever since the giant bubble burst in 1990 the Japanese government has tried frantically to spend its way out of the recession, but it merely managed to aggravate and prolong it. It sustained insolvent banks and insurance companies, subsidized favorite industries, and always prevented needed corrections and readjustments. Massive deficits continue to consume the people's savings, and false interest rates sustain old imbalances and create new maladjustments. The Japanese malaise is self-inflicted; guided by spurious notions and doctrines Japanese politicians unbendingly and doggedly pursue baneful policies.

Declining prices do not call for contravening central bank maneuvers that hopefully stabilize prices. Actually, whether the given stock of money is large or small, it renders the desired exchange service. The popular notion that an increase in the stock of money is

socially and economically beneficial and desirable is one of the great fallacies of our time. It has lived on throughout the centuries, embraced by kings and presidents, politicians and businessmen. It has shattered numerous currencies, inflicted incalculable harm, and caused social and political upheavals. It springs forth, again and again, no matter how often economists may refute it.

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Send in the Marines?

by Llewellyn H. Rockwell, Jr.

One of many costs of war is the impression it gives that government is a savior, a glorious means by which social problems are solved and a mechanism for the righting of wrong. In all postwar times, we can count on interventionists to invoke the war analogy to address a huge range of problems. If the government can do such a great job in war, it is asked, why shouldn't it also manage the economy, cure disease, abolish unemployment, end poverty, and 10,000 other things?

This is not just a rhetorical tactic; it is represents grave ideological degeneracy that is encouraged and promoted by war. War prepares the public for the idea that government is the answer to problems, not a deadly machine that specializes in destruction and killing, something to be feared and restrained as the founding fathers believed, but a liberator, a bringer of high ideals, the means by which the greatest things are accomplished.

In praising the troops, President Bush implied as much: "Operation Iraqi Freedom was carried out with a combination of precision and speed and boldness the enemy did not expect and the world had not seen before.… You have shown the world the skill and the might of the American armed forces…. Wherever you go, you carry a message of hope."

Hope! In the same speech, he mentioned faith and charity too, thus showing how all the virtues taught by God Incarnate are embodied in the act of blowing things up and killing people in distant lands. Now, this kind of language can be dismissed as boilerplate, but in fact it has repercussions in domestic policy. The advocates of big government seize on this to make the case for government to actively intervene in all aspects of life. If the armed forces really bring a message of hope *wherever they go*, maybe they should come to your town. If the world can be shown the might and skill of the American military, why shouldn't it be shown to America as well?

The prize for being the first to invoke the war analogy goes to the *Wall Street Journal*, which, when commenting on the shabby state of public schools, offers the following: "if Saddam's weapons of mass destruction were sufficient reason to invade Iraq, he should now send in the Marines to occupy and reconstruct the nation's dysfunctional public schools."

So there we have it! Forget all the debates, the careful thinking, the research, the details, the hard work, the experience of centuries. Just send in the Marines and be done with it! Such is the mentality of statism that war unleashes.

The data reported in the WSJ article itself is highly interesting. According to a new poll, 71% believe that public-school students do the bare minimum to get by. Some 43% of teachers say they spend more time keeping order than teaching, and 83% say the parents' failure to discipline kids at home is a serious problem.

There's more. Three-quarters of respondents say there is a serious discipline problem at public schools. Two-thirds of college professors say public schools are either fair or poor. Three-quarters of employers believe that public-school grads have only fair or poor writing skills, and they complain of the students' lack of math and organization skills.

The conclusion the *Journal* draws is not unwarranted: Americans are terribly dissatisfied with public schools. While the article includes a perfunctory call for the usual combination of vouchers and charter schools (both government "solutions" too), the really notable rhetorical turn comes with the author's suggestion that the Marines should occupy the schools and fix them up. Now, we might laugh at this as nothing but a flourish, but it illustrates the key problem in this country today: the belief that government is the answer and freedom is not.

Note that the ideological "right" is as much, or more today, entranced by this idea that violence works than the "left." It is possible that the left might even learn a general lesson here. Perhaps it will occur to some of them that a government so lying and brutal to have pulled off this war should not be trusted to run the schools, the health system, or the economy. It's doubtful that they will learn this, but there is the hope.

On the right, however, there is little hope. Having spent a lifetime following and participating in conservative intellectual circles, I can report that I've never seen more faith in government than is alive in these circles today. This war and the Bush presidency have caused a huge resurgence in the belief that power alone can accomplish great, transforming miracles.

Not 1 in 10,000 Republican conservatives has an inkling of the most basic insights of the old liberal faith in freedom, to say nothing of the founders' fears of government power. For most of them, the proper political philosophy amounts to nothing more than power lust backed by chauvinism. They have become proud to behave exactly like leftwing caricatures of themselves: fascistic, anti-intellectual, longing to be led.

Left or right, statism is an intellectual disease that transcends party attachments. It stems from the false hope that men with guns can make an end run around all the problems in the world. It imagines great leaders riding in on white horses (or flying in on jets and landing on aircraft carriers) who can at last put an end to all debates and take decisive action. Courage and derring-do, backed by men with bombs, it is believed, can accomplish great deeds!

On the left, this ideology is called socialism and on the right it is called fascism, but it always amounts to the same principle: that dictatorship and regimentation is to be preferred to letting people alone.

To believe in statism requires a leap of faith, and once that leap is taken, it becomes ever easier to believe that the plan worked, even when all evidence points the other way. In the Iraqi case, as Bush spoke about liberation, US troops were firing more rounds at Iraqi citizens protesting the occupation. As Bush said that the troops were bringing hope to all, and avoiding civilian casualties, bullets were ripping through the flesh of innocent Iraqis who simply want the US to leave them alone. In fact, it is increasingly clear that the only political consensus in Iraq right now is that the US must go, an impulse the US is dedicated to stamping out.

Under the statist faith, to draw attention to such realities constitutes an act of apostasy. Let those who say there are costs to war be *anathema*! The downside must never be mentioned. In his speech, for example, Bush said the Iraq war was a good thing with two sentences, the first one false and the second one preposterously true by definition: "We have removed an ally of Al Qaeda, and cut off a source of terrorist funding. And this much is certain: no terrorist network will gain weapons of mass destruction from the Iraqi regime, because that regime is no more."

What he did not say is more interesting. Before the war he said: "The goals of our coalition are clear and limited. We will end a brutal regime, whose aggression and weapons of mass destruction make it a unique threat to the world." After, he said nothing about the failure to find WMD, the primary excuse for this invasion.

Moreover, he said nothing about the evident failure to kill Saddam. He didn't say how many lives were lost. He said nothing about the looting, the chaos, the death, the destruction, the plagues, the hunger, the misery. He said nothing concerning the most obvious fact that Iraqis do not want Americans there. He said nothing about the possibility that Iraq will become either an Islamic dictatorship or a prison camp run by the US. In fact, every word of his speech was malignant fantasy.

The application of the same model applied to domestic policy partakes of the same tactics. The Bush administration is pushing for a nationalization of educational standards. The costs will be enormous and the failure evident to anyone who can stand to look. But the state never admits failure. To the state, freedom (genuine freedom, not the false freedom brought by bombs and invasions) is always failing and the government is always succeeding. The state's propaganda turns reality itself upside down.

Returning to the topic of education, clear thinking on the question reveals that the answer to our woes requires not more of the thing that is failing (the state) but precisely the opposite. It is the exercise of freedom, not the use of military troops, that has given us home schools and private schools that have performed so magnificently. But these exist despite every effort of government to crush them. They represent flowers that have sprung up through the pavement of the state. To suggest, even in jest, that the Marines be sent in to fix education amounts to calling for the cement truck.

The critics of libertarianism claim that in our hearts, we hope the state will fail. That's not precisely true. What we know is that the state *will* fail. Its alleged victories are always a myth in the long run. It takes no leap of faith to see the mess that power has made of the world. The glories of peace and freedom, on the other hand, are evident for all those willing to take off the blinders of statism.

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Awaiting Inflation

By Christopher Mayer

"By the pricking of my thumbs, something wicked this way comes." - Shakespeare, *Macbeth*

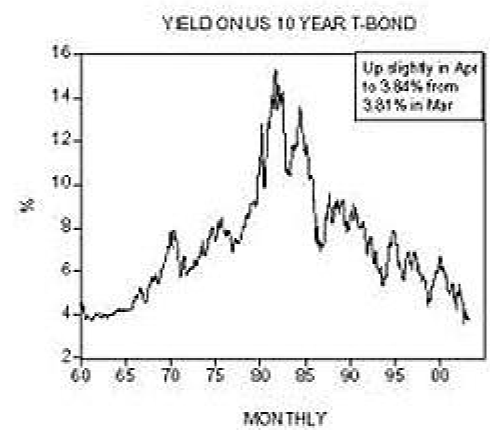
Humphrey Neill's little gem of a book, *The Art of Contrary Thinking*, was groundbreaking in at least one respect. Published in 1954, it gave the English-speaking world a new word, at least according to the lexicographers of the *Oxford English Dictionary*. Neill's dedication in this book is the oldest citation of the word contrarian. "To Contrarians and Libertarians everywhere," Neill declared, "May there numbers grow"!

Neill then went on to develop his idea of contrarian thinking. Contrary thinking certainly has roots older than 1954, but perhaps never before had any writer so carefully and explicitly dealt with the subject as Neill did.

In any event, the theory of contrarianism advises that you "Thrust your thoughts out of a rut. In a word, be a *nonconformist* when using your mind." Or, to use another oft-quoted Neillism, "When everyone thinks alike, everyone is likely to be wrong."

It is after thinking about Neill's pithy nuggets of wisdom that one can't but help feel a sense of unease about the consensus views on the risks of inflation. Inflation, in the sense used here, is the popular one used to describe a phenomenon of generally rising prices, or stated in another way, a decline in the purchasing power of the dollar. Though that definition is less than ideal, it is widely used. For the moment, a concession to popular prejudice is made to focus on the point at hand. The primary point is to warn, as does an old Malay proverb, that just because the river is quiet does not mean the crocodiles have left.

Interest rates, as all homeowners can attest, are very low when viewed against a longer historical backdrop. It is a commonly served dish of economic commentary that home mortgage refinancing and the housing market generally have helped sustain the economy despite recent weakness in many other lines of business. Across the spectrum, rates are low. The ten-year Treasuries are priced to yield around 4%. Earlier in the year, the yield on that instrument touched a 45-year low – a miniscule 3.56% – a yield not seen since the summer of 1958. Those who bear the monetary scars inflicted by the destructive powers of 20th century inflation surely had to rub their eyes in disbelief.



These veterans know that the bond market's reputation for absolute safety is undeserved. After all, there are plenty of instances in history where bond investors were fleeced. Investors lent money to the US government to finance World War II at rates of 2.5% for terms of between ten and twenty years in length. By doing so, they committed themselves to a 2.5% return on their money on the eve of a massive period of inflation. Those investors who held these bonds for the duration suffered major losses as inflation ate away at their savings.

Apparently, the message today from the bond market is that inflation is not a worry. The purchasing power of the dollar is secure enough, bondholders seem to say, that it is okay to tie your money up for ten-years at 4%.

So too, on an anecdotal level, inflation worries are simply nowhere to be found in the nation's leading newspapers. Inflation worries have elusively slipped off-stage, like an aging diva that has been pushed from the limelight by a younger and sexier performer.

War and terrorism are the new glamour girls of news that dominate the headlines, deservedly so, it might be said. Even if they did not, there are a host of other concerns likely to get top billing before inflationary worries these days. Among them, the budget crises of most state and local governments, for example, or the spiraling cost of health care.

Yet, there are clues and warnings, beyond mere contrarian instincts, that inflation will once again have her day.

James Grant, in *Grant's Interest Rate Observer*, expresses concerns about the price tag of the war with Iraq, recently estimated by the administration at $74 billion, sans occupation and re-building costs. The monetary cost of the war is anybody's guess and true to the nature of guesses, they range over a wide field. In addition to the cost of the war itself, Grant notes the accommodating role the Federal Reserve Bank historically plays in supporting the expenditures of the national government. The two together–spiraling war and post-war expenses, and the easy credit of the Fed–possess sufficient power to stir the inflationary pot, in Grant's view.

Summarizing the action of the bond markets, Grant's writes "The new consensus of opinion in the bond market holds…[that] heavy public borrowing, fast-paced debt monetization, and high commodity prices are non-inflationary. We had somehow believed the opposite." The juxtaposition of these conflicting things has not gone completely unnoticed. Bill Gross, too, has written about them in his past letters to shareholders.

Bill Gross, the reigning bond guru and manager of the world's largest bond fund, wrote in his latest letter to shareholders that "the salad days are over" by which he meant that with rates as low as they are, bondholders could no longer expect the returns of the past. He warns, "should reflationary efforts take hold, price protection will be the order of tomorrow."

Then there is the message from the commodity pits. The DJ-AIB Commodities Futures index, depicted in the *Wall Street Journal* everyday, is up 16% from a year ago. Gold, oil, natural gas, and other natural resources have been rising. International turmoil may explain some of these increases, but the movements are broad enough for some to conclude that something more propels these commodities.

Outstanding Investments, a newsletter dedicated to following the natural resource market, wrote in its March issue that the commodity price increases represented "the latest manifestation of an inflationary environment." Here in the commodity pits, at least, there would seem to be some clue that the purchasing power of the dollar may not be as secure as bondholders hope.

Beyond this, there is perhaps the most powerful reason of all – fiat currency is simply no good. Theory and history agree that its value only diminishes over time. It's primary weakness is what Fed governors think is its greatest strength. The printing press analogy has been used not only by critics of fiat currency, but also by Federal Reserve Board governor Ben Bernanke, who in a November 21 speech said that the government can "produce as many U.S. dollars as it wishes at essentially no cost." Yet another shot across the bow for those who still believe inflation is dead.

Some writers are always on guard against inflation, realizing that it is the nature of the beast that is fiat currency. S. Allen Nathanson, a corporate executive and life-long student of finance, wrote a series of wide-ranging essays appearing mainly in the years 1966-1973. These letters have been collected and re-published recently under the title *Bullishly Speaking*.

One persistent thought expressed in the book is the author's never-dying fear of inflation. He wrote, "The more I study the more I consistently return to the same conclusion. The entire world is imbibing from the same bottle, the bottle of inflation–each country's hangover consists of a currency that is shrinking in value similar to a cube of ice that slowly melts in a glass of water."

In another passage, Nathanson wrote, "Inflation is an American way of life. It may hesitate but never stop. Perhaps in our lifetime it may only creep, but there is always a possibility that it will start to gallop." There is some irony in the fact that Nathanson wrote during a time when there was still some semblance of a gold standard still in place, though he correctly predicted its demise even in his early essays.

It seems that in post-bubble America, at the dawning years of the 21st century, people have forgotten that this horse still has legs and the barn door is wide open and unattended.

Inflation is a process that forcefully re-distributes wealth from one group to another. Prices do not change uniformly in this process, and those that get the new dollars before their costs have risen gain at the expense of those whose costs rise first.

Austrian economics has long taught that analysis of inflation must proceed sequentially as it courses through the economic system. Moreover, it is this inflationary process that sets the cycle of boom and bust in motion. Prices are distorted and investments are inevitably made in unsustainable lines, leading ultimately to a liquidation, or bust, revealing the precious capital that had been wasted.

The only way to stop such a process is to separate money and government. Free-market money mean money backed by something other than the decree of government promising to replace paper with paper.

It is for the reasons outlined here that the fate of the dollar and with it, the savings of millions of Americans, is less than bright. Our future standard of living depends on our ability to return to a sound currency. For hundreds of years, gold was good enough. Let's hope that it will be again.

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Is the Tax Cut for Real?

By James Ostrowski

May 29, 2003

Polls suggest that only 45 percent of the public backs the tax bill signed by President Bush, which means that a majority are against it, indifferent, or confused. Now, we can dismiss the idea that people don't want tax cuts. After all, if people wanted to pay taxes, we could just make them voluntary and be done with it. They are called taxes because people are being forced to pay for something they would otherwise not pay for. Asking people if they want a tax cut should be like asking if they want less mugging.

How, then, can we account for the polls that show limited support? Perhaps people have been conned one too many times by tax changes that always promise to lighten the load but somehow never do. Perhaps the trick is just a bit too transparent.

Still, the Republican power elite has to con the Republican rank and file once in a while. The rank and file wants smaller government and they actually believe the Republican Party intends to accomplish that goal. This is in spite of the fact that the Republicans have failed to accomplish this goal for seventy-five years and the Republicans got us on the road to big government in the first place in 1861.

How can I complain about a tax cut? Because what matters is not cutting "taxes" but cutting taxes. That is, what needs to be cut is not what we call "taxes" but the total amount of money that government takes out of the economy—the real tax rate. Basically, this is what government spends and legally commits to spending in the future.

Spending is based on what government "taxes" but also what government borrows and inflates. It's quite simple. If government spends it, we can't spend or save or invest, and that's bad. As Murray Rothbard explained, deficit spending leads either to inflation or to crowding out private capital investment. Either horn of the dilemma reduces wealth.

What is Bush's record on spending? As Jeffrey Tucker and Lew Rockwell have noted, it's awful. The Bush administration inherited a federal budget of $1.86 trillion, and now proposes to spend $2.3 trillion in 2004, for a whopping 23.6 percent increase in federal spending in this short period. The Bush presidency has far outspent Clinton's in every category. As Cato's Chris Edwards says, "[B]ased on his first three budgets, President Bush is the biggest spending president in decades." To close the gap between spending and revenue, said a report commissioned by the US Treasury, would require an "immediate and permanent 66 percent across-the-board income tax increase."

Also, despite talk of deflation, your dollar has lost about four percent of its value under Bush. That means, for example, that if you had $50,000 in the bank when he was elected, the feds managed to burn $2,000 of it. Cancel that vacation. Just keep working like a jackass, the fate of those who allow their freedom to slip away without a peep of protest.

In addition to spending, we must analyze regulations to determine the trend under the Bush Administration. A regulation is essentially a tax on nonmonetary wealth such as time, liberty, energy, and property. Bush's regulatory record is mixed, but new regulatory initiatives have occurred on Bush's watch. Examples include an extremely burdensome scheme for regulating medical records, new banking regulations which destroy financial privacy, and new federal controls over local public schools.

There is yet another type of tax that must be considered—blowback. Yes, 9/11 was a kind of tax on the American people, the destruction of our lives and wealth by those who are unhappy with the federal government's numerous and obnoxious interventions into lands far, far away.

Then there is the risk of future blowback, a real economic cost and thus a form of taxation by blowback. We Americans now wear a target on our backs. Strange men at airports use that as an excuse to feel our private parts. Other strange men from strange lands would like to kill us to send a message to our federal Leviathan.

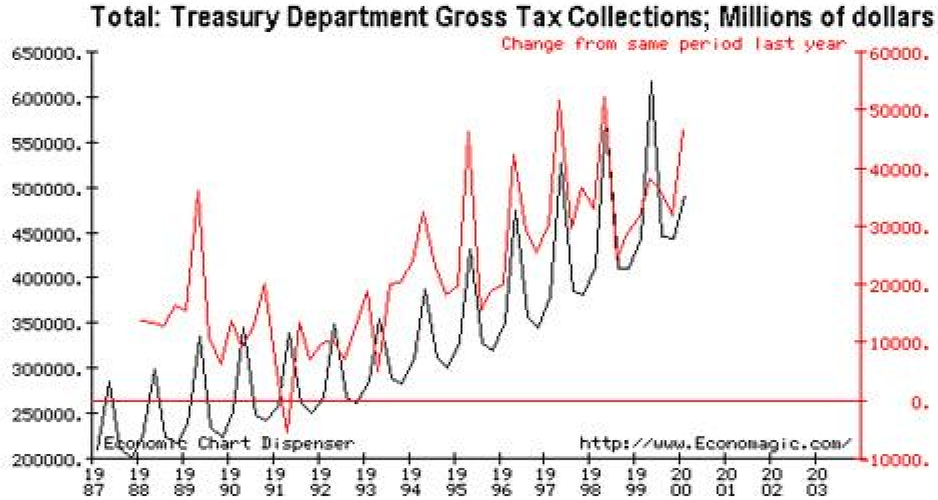
These terrorists apparently think the feds care about our lives or that we have some influence over the federal government. If they only knew. Years ago, I happened to be in D.C. and decided to drop in impromptu on my Senator, Al D'Amato, to discuss one of his awful votes. The lazy young staffers in the palatial suite thought it was the oddest thing. The look on their faces in reaction to my breaking up their little office party was like, should we call for a psychiatrist, or security or what?

Also, a few years ago, I attempted to contact the Senate Judiciary Committee to speak against the appointment of a political hack nominated to be the U.S. Attorney in Buffalo. Despite my best efforts, I was completely ignored. At least in a Stalinist country, I would have gotten a response.

As for the "caring" part, Americans were murdered on 9/11 because of the feds' insane foreign policy. Rather than change that foreign policy, the feds have intensified and reinforced the same errors that led to 9/11. Without using street language, how do you describe those who make a good living by fervently clinging to failed ideas that have killed thousands of people?

There are (bad) arguments for cutting taxes without cutting spending. First, they argue that creating huge deficits is the only way to rein in spending. We heard this Machiavellian strategy under Reagan in the Eighties. I guess it didn't work because the federal government has been growing steadily ever since. No major program or department, even the utterly useless, thoroughly corrupt, patently unconstitutional and extremely destructive Department of Housing and Urban Development (a.k.a., Dept. of Neighborhood Destruction and Political Corruption), has been eliminated.

The reality is that spending creates constituencies which exert a powerful force for raising taxes rather than cutting spending. That is why, according to Bruce R. Bartlett, "there have been 15 major tax bills since 1980. Of these, 11 were tax increases. Ronald Reagan, the arch tax cutter, signed into law 6 of them, including the Tax Equity and Fiscal Responsibility Act of 1982, one of the largest tax increases in history." Nice try, but the only way to cut spending is to cut spending.



The other argument we can quickly dismiss. By cutting taxes, we can make the saps work harder and raise even more money for the welfare/warfare state. No thanks! If cutting the tax rate a few percent will increase the private sector's incentive to increase productivity, won't a *100 percent* salary cut create a powerful incentive for the political class to get real jobs and do real work?

Even on the specifics, this tax cut is not what it is advertised to be. It addresses capital gains but not capital losses. The child tax credit is subject to strict income limitations on both the upside and downside. It doesn't change the dangerous Alternative Minimum Tax, which will devour the middle class, given time. Many breaks in stealth taxes like the personal-exemption phaseout and the limitations on itemization aren't scheduled to take effect for several years. We won't know until later how many tax increases are snuck into the bill.

This much is clear from the total picture: this tax package is not about smaller government. It is about changing the way ever-bigger government is to be funded. It has already given rise to speculation that it is only the first of many steps toward a national consumption tax. And the terrible problem of the payroll tax, which now accounts for 37.8 percent of all federal receipts, isn't addressed at all, though it would be a good time to do so.

So, the evidence is in and a verdict can be delivered. Like every other Republican president since and including Hoover, George Bush has failed to reduce the size, scope, and power of the federal government. On the contrary, he has increased all three, making the federal government a much bigger nuisance than it was even under the administration of President Clinton.

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Aging Population

Jeffrey Tucker 6/16/2003

USA Today offers an outstanding analysis of why an "Aging Population Makes this Deficit Scarier" than the one in the 1980s: "When deficits started taking off 20 years ago, the retirement of the baby boom generation was just a distant worry. Now, as the nation faces years of red ink, including at least a $400 billion shortfall in 2003 alone, the graying population is a fast-approaching reality that will put unprecedented strains on Medicare, Social Security and the economy starting around 2010. ... Legislation to add a 10-year, $400 billion prescription drug benefit to Medicare, which the Senate could vote on this week, could make the problems far worse. The White House, which originally wanted any drug bill to include major changes to reduce costs and move Medicare closer to the private insurance market, has largely dropped those demands.... Today, Social Security and Medicare payroll taxes are generating a trust fund of surpluses. But by 2008, the government will have to start pumping more money into Medicare. Even without a drug benefit, the health program alone is expected to consume 20% of all revenue by 2026."

New Deal Anniversary

Chris Westley 6/16/2003

Today is the 70th anniversary of the creation of the National Recovery Act, Glass-Steagall, and several other New Deal laws that helped make the 1930s the "happy days" that they were. (They were actually American attempts to imitate European fascism.) The New York Times is offering copies of its June 16, 1933, issue for sale, and you can read the lead story describing the legislation here. A quote:

"Senators Wagner and Robinson of Arkansas and Representatives Doughton and Ragon were present at the signing of the Industrial Recovery Act. President Roosevelt's statement follows:

"History probably will record the National Industrial Recovery Act as the most important and far-reaching legislation ever enacted by the American Congress. It represents a supreme effort to stabilize for all time the many factors which make for the prosperity of the nation and the preservation of American standards.

"Its goal is the assurance of a reasonable profit to industry and living wages for labor, with the elimination of the piratical methods and practices which have not only harassed honest business but also contributed to the ills of labor.

"While we are engaged in establishing new foundations for business which ultimately should open a return to work for large numbers of men, it is our hope through the so- called public works section of the law to speedily initiate a program of public construction that should early re-employ additional hundreds of thousands of men.

"Obviously, if this project is to succeed, it demands the wholehearted cooperation of industry, labor and every citizen of the nation."

What are the common features of a growing economy? These:

1. A high savings rate
2. Minimal government regulations on the economy
3. Low taxes, especially on capital gains
4. A culture favoring entrepreneurship
5. Future-orientation of the masses (save!)
6. Stable money
7. Freedom of contract
8. A court system that enforces contracts
9. A growing population

------ Gary North

Dead Men Talking

by Bill Bonner

"Tradition...is the democracy of the dead."

~ G.K. Chesterton

Yesterday's news brought word, from deputy Defense Secretary Wolfowitz, that U.S. troops would be in Iraq for the next 10 years. Also came an estimate of the cost: an extra $3 billion would have to be added to the defense budget for Iraq...and an extra $1.5 billion for Afghanistan.

"Avoid foreign entanglements," cautioned the father of the country. But corpses have no voice and no vote, neither in markets nor in politics. They might as well be dead.

George W. Bush is undoubtedly better informed than George Washington...and, heck, it's a new era; having foreign entanglements is just what the times seem to call for. George W. Bush may not have the wisdom of a Washington...nor the brain...but at least he has a pulse.

Few people complain about this tyranny of the living. Most accept it as a fact of life. They would not want people to be excluded from the pleasures of life because of an "accident of birth." But they are perfectly happy to have the oldest and wisest of our citizens systematically barred from the polling stations and the trading floors by an accident of death. The departed shut up forever, leaving behind them their car keys and their stocks, and their voter registrations...that is all there is to it. Goodbye and good riddance. It is as if they had learned nothing useful...noticed nothing...and had no ideas that might be worth having, as if each generation were smarter than the one that preceded...and every son's thoughts – even the present "culture of the moron" – improved upon those of his father.

Oh, progress! Thou art forever making things better, aren't thou? Throw out the sacred books – for what are they, but the thoughts of imbeciles? Forget the old rules...the old wives' tales...the traditions...habits of generations...the old timers' superstitions...the old fuddy-duddies doubts! We are the cleverest humans that have ever lived, right?

Maybe. But we convene a council from the spirit world; we invite the dead to have their say. Our aim is not to kvetch on behalf of our ancestors...but to warn the living: the corpses may have a point.

Many times have we referred to old timers' wisdom. The old timers wanted more from a stock than just the hope that someone might come along who was willing to pay more for it. They wanted a stock that paid a dividend...out of earnings. That was what investing was all about.

But by the 1990s, the old-timers on Wall Street had almost all died off. Stock buyers no longer cared how much the company earned or how much of a dividend it paid. All they cared about was that some greater fool would come along and take the stock off their hands at a higher price. And so they did. And now the market is full of them...greater and greater fools who think the stock market is there to make them rich.

In the space of 20 years, the character of the American economy and its markets changed so dramatically, the old-timers would scarcely recognize them. We mentioned yesterday how, in the mid-'80s, the U.S. slipped below the water line separating the net-creditors from the net-debtors. But almost no one noticed or cared. By then, the old-timers were already in Florida shuffling along, like the Mogambo Guru, waiting for someone to adjust their medication.

"In 1981," Marc Faber explains, "stock market capitalization as a percentage of GDP was less than 40%, and total credit market debt as a percentage of GDP was 130%. By contrast, at present, the stock market capitalization and total credit market debt have risen to more than 100% and 300% of GDP respectively."

We have wondered how this ends. Not well, is our guess. Too much debt and credit, too much capacity, too many dollars, too many bad investments, too much spending, too many deficits and too much confidence...What is the solution? "Less" is our recommendation. "More," say Bernanke, Greenspan, Bush, and everyone else in a position to do something about it...

And so the whole thing rolls forward...towards its inevitable destruction. Because, and here the dead back us up 100%, all paper currencies sooner or later come to grief. The "if" question is settled. "When...and how" remain open.

And so, we turn to ancestors...and ask for advice.

"The state's need of money increased rapidly," says one of them, Bresciani-Turroni, describing the scene in Germany 80 years ago. "Private banks, besieged by their clients, found it impossible to meet the demand for money...."

As the situation heated up in the summer of 1923, there were some who gave our advice: "Less," they said.

But officials were in roughly the same situation as Bernanke and Bush today. "More," said they.

One, named Helfferich, the finance minister, explained:

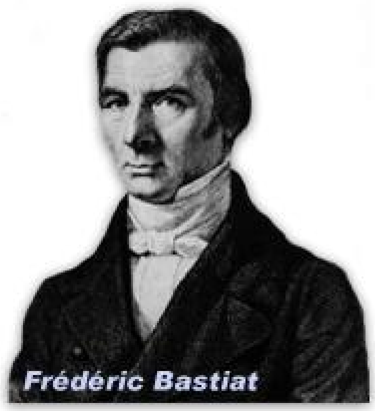
"To follow the good counsel of stopping the printing of notes would mean – as long as the causes which are upsetting the German exchange continue to operate – refusing to give economic life to the circulating medium necessary for transactions, payments of salaries and wages, etc., it would mean that in a very short time the entire public, and above all the Reich, could no longer pay merchants, employees, or workers. In a few weeks, besides the printing of notes, factories, mines, railways and post office, national and local governments, in short, all national and economic life would be stopped."

When an economy comes to depend on more and more credit...it must get more and more of it...or it will come to a stop. A man who has borrowed heavily to finance a lifestyle he cannot really afford...must continue borrowing in order to keep up appearances. Or else he must stop. In market manias, love, politics, war...people rarely stop until they are forced to.

In Germany, once the Great Inflation got started, there was no stopping it until it had run its course. In 1921, a dollar would buy 276 marks. By August of 1923, it would buy 5 million of them. Middle-class savers were wiped out.

If only we could roust Herr Helfferich from his eternal sleep! We would like to shake the dust off his wormy cadaver and ask some questions. (And here, we think not of praising the dead, but of tormenting them.) What fun it would be to show him what his policies – the same, by and large, as are now put forward by Greenspan, Bernanke and Bush – provoked. How gratifying it would be to see the little kraut squirm under an intense interrogation: what was he thinking, after all? Why did he think that more of the dreadful printing press money would undo the harm that had already been done by too much?

Bresciani-Turoni continues:



"The inflation retarded the crisis for some time, but this broke out later, throwing millions out of employment. At first inflation stimulated production...but later...it annihilated thrift; it made reform of the national budget impossible for years; it obstructed the solution of the Reparations question; it destroyed incalculable moral and intellectual values. It provoked a serious revolution in social classes, a few people accumulating wealth and forming a class of usurpers of national property, whilst millions of individuals were thrown into poverty. It was a distressing preoccupation and constant torment of innumerable families; it poisoned the German people by spreading among all classes the spirit of speculation and by diverting them from proper and regular work, and it was the cause of incessant political and moral disturbance. It is indeed easy enough to understand why the record of the sad years 1919–23 always weighs like a nightmare on the German people."

There, the dead have had their say.

Frédéric Bastiat's Views on the Nature of Money

By Mark Thornton

What is money? This is a question for the ages. Humanity has risen into complex society and experienced tremendous economic development and high cultural achievement through the use of money. It has foundered or even been destroyed when money has been undermined. Ignorance of the nature of money should therefore be the central economic issue for society.

Frédéric Bastiat was a French businessman who lived during the first half of the nineteenth century (1801–1850). In the last few years of his life he was elected to the national assembly and began a prolific career as a writer on topics of economics, public policy, and political issues of the day. His highly effective writing style includes the use of humor, ridicule, dialogue, irony, exaggeration and, most important, logical deduction and the process of elimination. He is like a mystery sleuth in search of economic truth and this style has made him the undisputed champion in economic polemics. He continues to earn high praise from journalists, economists, and most important, from educated readers more than 150 years after his death.[1]

In contrast to the universal respect and admiration for his literary skills, Bastiat has not been admired as an economic theorist. His efforts at economic theory have been roundly criticized and characterized as the efforts of an amateur or even a crank. We can list the eminent economist Joseph Schumpeter and Nobel Laureate F.A. Hayek, two outstanding economists, among the critics of Bastiat as an economic theorist.

I have re-examined Bastiat's contributions to economic theory and have found the charges against him to be unsubstantiated. In terms of economic theory, Bastiat is widely knowledgeable, keenly discerning, highly competent, and very creative. Furthermore, I have concluded that the central criticisms of his detractors are unjustified because they are based on an interpretation of Bastiat's theories that is at odds with the large body of Bastiat's views on economics.

These critics place Bastiat in a camp that believes that people do not benefit from trade (zero sum theory of exchange) and that the value of a good actually resides within the good itself (intrinsic value). It is simply preposterous to believe that Bastiat held such beliefs and to interpret his theory in this manner. Bastiat was arguably the most consistent economist of all time, an achievement that was nurtured by many years of serious study before embarking on his political and publishing career a few years before his death. There may be something wrong in Bastiat's theoretical framework, but these critics have not identified it (Thornton 2001, pp. 387–98).

Had Bastiat lived to see the publication of his theoretical treatise, he would no doubt have defended and clarified his views, possibly modifying those views or their presentation. Bastiat certainly loved intellectual debate, and few people of his day or ours would relish going to battle with him.

Bastiat has received criticism in the area of monetary theory. Hayek wrote in the introduction to an edition of Bastiat's Selected Essays on Political Economy that Bastiat should not be blamed for his failure to address the important problems of monetary economics because Bastiat lived during the heyday of the international gold standard. With so many other problems in his day, why should Bastiat search for a solution where no problem existed?

The attentive reader will notice that, while Bastiat grapples with so many economic panaceas which are familiar to us, one of the main dangers of our time does not appear in his pages. Though he has to deal with various queer proposals for using credit which were current in his time, straight inflation through a government deficit seemed in his age not a major danger. An increase of expenditure means for him necessarily and immediately an increase in taxation. The reason is that, as among all people who have gone through a major inflation within living memory, a continuous depreciation of money was not a thing with which people would have put up with in his day. So if the reader should be inclined to feel superior to the rather simple fallacies that Bastiat often finds it necessary to refute, he should remember that in some other respects his compatriots of more than a hundred years ago were considerably wiser than our generation. (Hayek 1964, pp. xi–xii)

Many writers have appealed to Bastiat's writings on other subjects to analyze monetary problems and to offer monetary solutions. For example, appeal has been made to his views of the nature of government or trade to illuminate monetary issues. Others have tried to reconstruct what Bastiat would believe about money and some of these attempts can be judged quite successful.

I have searched through Bastiat's writings for something—anything—on monetary economics and have finally found an essay, "Maudit Argent" (1849)2. A translation of the essay appeared in English, in a long lost volume[2] of Bastiat's essays, by the great American economist David Wells in 1877. We are now able to see clearly if Bastiat has any economic lessons for us in the area of monetary economics.

Modern economists would probably scoff at the notion of using the dialogue method to present economic theory, but Galileo used it to describe the nature of the universe, and Plato certainly used it to good effect. Bastiat used dialogue to address the question, "What is money?" It is a dialogue between an economist who represents Bastiat's views and who begins the dialogue by shouting "Hateful money! hateful money!" (p. 174) after leaving a Committee of Finance meeting where a project of paper money has been discussed. His discussant is an acquaintance and an educated layman willing to learn how a failure to understand monetary theory "is to be found at the root of all economical errors" (p. 177).

Bastiat begins his detailed analysis of the nature of money with a stunning statement when he calls "drafts on the Bank of Exchange" a "deceitful substitute" for money. This clearly implies that banknotes and deposit accounts are fraudulent when they do not represent commodity money in the same way warehouse receipts represent the titles to nonmonetary commodities. Bastiat therefore begins his dialogue by labeling fractional reserve banking practices as a fraud on the general public.

Bastiat goes on to explain that the confusion of money and riches or wealth is the "cause of errors and calamities without number" (p. 176). Money is genuinely beneficial—indeed, it plays a critical role as the medium of exchange—but people confuse money with wealth. This is not a problem for the deluded individual who readily ignores this mistaken belief every time he gets hungry or thirsty and converts money into goods. However, when this mistaken belief becomes acceptable public policy all manner of destruction can be unleashed:

Because, when a man, instead of acting for himself, decides for others, personal interest, that ever watchful and sensible sentinel, is no longer present to cry out, "Stop! the responsibility is misplaced." It is Peter who is deceived, and John suffers; the false system of the legislator necessarily becomes the rule of action of whole populations. (p. 179)

When government concludes that money is wealth and enacts policies to draw money away from other nations, it accepts the doctrine that an individual and a nation can only prosper at the expense of others. In order to increase wealth, people must be prevented from spending their money on imports even if they are hungry, and must also be compelled to export their goods in order to increase the amount of money in society. An expensive system of customhouses will be necessary to prohibit imports and an expensive system of export subsidies will be necessary to encourage exports and all of this will require a large tax to be laid on the people. If other governments adopt the same view, then you must raise armies and navies to establish colonies and conquests that will then serve as customers for your goods and sources of money. If they in turn raise armies to contest your colonies and conquests, the process—"universal war" (p. 187)—becomes self-defeating and very expensive.

And, tell me, are not these custom-house officers, soldiers, and vessels, these oppressive taxes, this perpetual struggle towards an impossible result, this permanent state of open or secret war with the whole world, are they not the logical and inevitable consequence of the legislators having adopted an idea, which you admit is acted upon by no man who is his own master, that "wealth is money; and to increase the amount of money is to increase wealth?" (p. 186)

Of course, universal war is not the only result of the idea that increasing the supply of money can make us richer. Along with protectionism, colonialism (imperialism), heavy taxes, and the hatred of capital comes "the last and worst, paper money" (p. 188).

When legislators, after having ruined men by war and taxes, persevere in their idea, they say to themselves, "If the people suffer, it is because there is not money enough. We must make some." And as it is not easy to multiply the precious metals, especially when the pretended resources of prohibition have been exhausted, they add, "We will make fictitious money, nothing is more easy, and then every citizen will have his pocket-book full of it, and they will all be rich." (p. 188)

Bastiat then goes on to show that the notion of money as the source of wealth is incorrect, that trading goods and services is mutually beneficial, and that trade is merely facilitated by the use of commodity money as the medium of exchange. He then reinforces this point by noting that any rare metal can serve as money and that any quantity will be sufficient to serve as money. The policymaker need not increase the money supply at all:

Money serves only to facilitate the transmission of these useful things from one to another, which may be done equally well with an ounce of rare metal like gold, with a pound of more abundant material as silver, or with a hundredweight of still more abundant metal, as copper. According to that, if a country like the United States had at its disposal as much again of all these useful things, its people would be twice as rich, although the quantity of money remained the same; but it would not be the same if there were double the money, for in that case the amount of useful things would not increase. (p. 191)

Bastiat is adamant that any increase in the supply of money does not benefit society and does not increase satisfaction. You simply do not make the citizenry better off by forcing them to give up useful things in return for newly created money. What is good for the individual (more money) is not good for the nation as a whole, and Bastiat invents an ingenious game to explain inflation and debasement. He then explains that money represents value that the holder has provided to someone else in society either by goods or labor, and the holder can take money and exchange it with others for goods or labor of a similar value.

Bastiat laments: "It is impossible for society to render more services than it receives, and yet a belief to the contrary is the chimera which is being pursued by means of the multiplication of coins, of paper money, etc." (pp. 200–01). You cannot solve the problems of society, nor raise the standard of living simply by increasing the supply of money.

Bastiat's companion asks, why not give an increase in the supply of money a try, even if it will not work. At least it will not cause any harm and will give people some hope that social problems can be addressed. Beginning with a fictitious construction similar to what is now referred to as the helicopter model, Bastiat replies "after the issue of paper money and its depreciation, the equilibrium of values should instantly and simultaneously take place in all things and in every part of the country" then "the best thing we could do would be to look at one another and laugh" (p. 205).

But this is not how it works in the real world. When you force people to take false money in return for real goods and services, the alteration of money creates real changes in the world, and, rather than providing a mechanism for solving real-world problems or even of just providing hope to the poor and the downtrodden, inflation actually creates real problems and injustices for the least advantaged members of society.

I must inform you, that this depreciation, which, with paper, might go on till it came to nothing, is effected by continually making dupes; and of these, poor people, simple persons, workmen and countrymen are the chief. (p. 206)

During inflation the ability to calculate is blurred and this is especially so among the average working class people who are unable to identify the reason for their impoverishment. Bastiat notes that a "day's pay of a country laborer will remain for a long time at a dollar while the salable price of all the articles of consumption around him will be rising" (p. 211). He goes on to note that, because the rise in prices cannot be "instantaneous and equal for all things" (p. 212), inflation also contributes to the chief problem of those who wish to use money to solve social problems, the inequality of wealth in society.[3]

Sharp men, brokers, and men of business, will not suffer by it; for it is their trade to watch the fluctuations of prices, to observe the cause, and even to speculate upon it. But little tradesmen, countrymen, and workmen will bear the whole weight of it. (p. 212)[4]

There are many more problems with inflation, but the discussants grow weary. Bastiat tries to summarize his conclusions by noting that "these questions are of the highest importance; for peace or war, order or anarchy, the union or antagonism of citizens, are at the root of the answer to them" (p. 217), and goes on to question, how can all civilized nations avoid the study of such critical information. Bastiat's companion replies that the state fills men's minds with prejudices and sentiments "favorable to the spirit of anarchy, war, and hatred" (p. 218), because the state takes us at an early age and:

It puts a bandage over our eyes, takes us gently from the midst of the social circle which surrounds us, to plunge us, with our susceptible faculties, our impressionable hearts, into the midst of Roman society. . . . How can you expect them to take the slightest interest in the mechanism of our social order? (pp. 218–19)

Bastiat ends the dialogue with his recommendation for reform:

The most urgent necessity is, not that the State should teach, but that it should allow education. All monopolies are detestable, but the worst of all is the monopoly of education. (p. 220)

Clearly, rumors of Bastiat's lack of interest in monetary theory have not only been exaggerated, they are patently untrue. Indeed, Bastiat places the role of money at the center of the economy and portrays ignorance of its nature as one of its greatest dangers. Not only does he explain the nature of money, but he also very cogently explains the inevitable results of a failure to understand that nature.

Bastiat's analysis is so advanced that it is prophetic. Not only does he explain the inevitable consequences of mercantilist monetary policy, but he also goes on to explain the critical weaknesses of modern equilibrium approaches to monetary theory and monetarism. As one views the world and sees global economic chaos, growing class conflict, widely divergent economic opportunity, and perpetual war, Bastiat provides a clear and concise guide to its cause. Bastiat's solution no doubt rests in the true understanding of the nature of money by the citizens, the abolition of fiat money and central banks, and a return to commodity money such as gold and silver coins.

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