

Leithner Letter No. 108-110 26 December 2008 - 26 February 2009

Everybody has asked the question, and they learned to ask it early of the abolitionists, "What shall we do with the Negro?" I have had but one answer from the beginning. Do nothing with us! Your doing with us has already played the mischief with us. Do nothing with us! If the apples will not remain on the tree of their own strength, if they are worm-eaten at the core, if they are early ripe and disposed to fall, let them fall! I am not for tying or fastening them on the tree in any way, except by nature's plan, and if they will not stay there, let them fall. And if the Negro cannot stand on his own legs, let him fall also. All I ask is, give him a chance to stand on his own legs! Let him alone! If you see him on his way to school, let him alone, don't disturb him! If you see him going to the dinner table at a hotel, let him go! If you see him going to the ballot-box, let him alone, don't disturb him! If you see him going into a work-shop, just let him alone – your interference is doing him a positive injury.

Frederick Douglass

[Annual Meeting of the Massachusetts Anti-Slavery Society \(April 1865\)](#)

Instead of furthering the inevitable liquidation of the maladjustments brought about by the boom, all conceivable means have been used to prevent that readjustment from taking place; and one of these means, which has been repeatedly tried though without success, from the earliest to the most recent stages of depression, has been this deliberate policy of credit expansion ... To combat the depression by a forced credit expansion is to attempt to cure the evil by the very means which brought it about; because we are suffering from a misdirection of production, we want to create further misdirection – a procedure that can only lead to a much more severe crisis as soon as the credit expansion comes to an end ... It is probably to this experiment, together with the attempts to prevent liquidation once the crisis had come, that we owe the exceptional severity and duration of the depression.

Friedrich A. Hayek

[Monetary Theory and the Trade Cycle \(1933\)](#)

Q: What do you say to the president who wants you and your fellow Republicans and Democrats to quickly pass this \$700 billion bailout package?

A: Well, I think that's a mistake because we don't have the money. But that doesn't mean you have to do nothing. I mean, we could reform the system. We could return to sound money. We could balance our budget. We could change our foreign policy. We could take care of our people at home. We could lower taxes. There's a lot of things that we can do. But the worst thing that we can do is perpetuate the bad policies that gave us this trouble in the first place, and that is that we no longer, over the last quite a few decades, [believe] in free-market capitalism ... So this \$700 billion is not going to do it.

This is Wall Street in big trouble and sucking in Main Street, now, and dumping all the bills on Main Street ... And you can't solve the problem of inflation, which is the creation of money and credit out of thin air, by [conjuring] more money and credit out of thin air. We have to change basic policy ... What they're doing now, they're propping up a failed system so the agony lasts longer. They're doing exactly what we did in the Depression. What the government is doing now – this new program is trying to prop up prices. You want the price structure to adjust. You want the price of houses to go down. You don't want to fix the price of housing. You can't price-fix. We've had too much of that.

[Ron Paul Has Nothing Good to Say About the Wall Street Bailout Plan](#)

The Los Angeles Times (21 September 2008)

Once Again, Marxism Fails Miserably: Long Live Marxism?

Are financial markets falling, or is the sky? At the moment the answer is debatable. During September and the first half of October, comparisons between current conditions and the early phases of the Great Depression filled the newspapers and airwaves.¹ In the 12 months to 10 October, financial markets in Australasia, North America and Western Europe suffered mark-to-market adjustments averaging 39%. In Australia, the loss of 42% greatly exceeds those incurred during the Crash of 1987 and the recessions of the early 1990s and 1980s, as well as many of the losses incurred during the Depression. The worst-ever annualised result since the birth of the All Ordinaries Index in January 1875 is the -43.5% in the twelve months to 30 September 1930 (which pipped the -41.6% of August 1974 and the -40.6% of September 1974). In the U.S., the DJIA and S&P 500 have plunged more in the past year than at any time since the “[Depression-Within-the-Depression](#)” of 1937-38.

It’s vital to distinguish a *panic* (also known as a *crash* or a *crisis*) from a *bear market*. The most important feature of each is a significant and perhaps drastic fall of the prices of stocks, bonds and other securities.² A panic is a transient phenomenon.

¹ The International Monetary Fund, in its bleakest forecast in years, says that the world economy is poised for a “major downturn” and that the U.S. and Europe are “either in or on the brink of recession.” The IMF reckons that the “worst financial trauma since the Great Depression” could exact a heavy economic toll. “The world economy is now entering a major downturn in the face of the most dangerous shock in mature financial markets since the 1930s,” said its *World Economic Outlook* released on 8 October. It added that although the world economy was unusually frail, there was little chance of a global depression – “provided [that] leaders quickly adopt policies to address market distress.” “If the right policies are in place, then the probability of a ‘Great Depression’ is extremely small.” In a news conference, its chief economist added that leaders in Europe were encountering “some difficulty” agreeing on how to deal with the crisis but the financial markets were forcing them to move quickly. If they succeed, “the risk of a ‘Great Depression’ is nearly nil.”

How seriously should one take these assertions? At the IMF, one year has made a mammoth difference. On 12 April 2007 its *World Economic Outlook* stated “rapid growth in the world economy is set to continue for years and will not be upset by financial instability ... The [outlook for economic growth and inflation] was better now than at any time since at least the 1960s and growth prospects were more balanced around the world now than they were then.” At a news conference, its chief economist added “I think we can sustain growth in GDP at around 5% a year for some time to come ... You will have some ups and downs in financial markets, but as long as the macro-economic policies are sound the issues in finance will not be of first order importance.”

But forget last year’s assessment: despite IMF’s utter inability to prophesy, the confidence with which it predicts remains undimmed. “Intensifying solvency concerns about a number of the largest U.S.-based and European financial institutions have pushed the global financial system to the brink of systemic meltdown,” said its managing director on the weekend of 11-12 October. Its chief economist added: “at the worst, governments will need another few weeks to make the right assessment and the stock exchanges could fall by another 20 per cent. Then there will be a turnaround.”

² Yes, there is a rare thing called a “buyers’ panic” which suddenly and unexpectedly causes the prices of securities to skyrocket. An example of such a panic is discussed on the next page. For the sake of simplicity and brevity, we’ll restrict our attention to the more common phenomenon “sellers’ panic” and will abbreviate this more common event with the simple label “panic.” For details, see Stephen Vines, *Market Panic: Wild Gyration, Risks and Opportunities in Stock Markets* (John Wiley & Sons, 2003).

Its duration is always less than a year, perhaps several weeks and sometimes just a day or two. Panics are occasionally financial but typically non-economic in nature. That is, financial developments can trigger them (as they did in 1929 and 2007), but economy-wide recessions – which develop neither overnight nor completely unexpectedly – do not. Examples of panics include shock outbreaks of war (such the attack on Pearl Harbour in 1941 and the outbreak of the Korean War in 1950); unforeseen military disasters (such as the fall of France in 1940 and of Singapore in 1941); and surprise political developments (such as the imposition in Canada of the War Measures Act and martial law in October 1970, and the events of 11 September 2001).

A bear market, on the other hand, is a medium- and sometimes a long-term event. Its duration is usually more than a year, is sometimes several years and on a few occasions has lasted more than a decade. Recessions and depressions are their most common cause.³ Hence the onset of the Great Depression, whose intensity and duration varied from country to country, caused bear markets from 1930 to 1942; the recession of the early 1970s caused bear markets from 1974-79, and so on. A panic does not cause, but can help to trigger, a bear market. That is, the sudden and unexpected eruption of a banking, credit or other financial crisis on Wall Street can over time spill into Main Street. Just such a thing seems to be happening at the moment. The “sub-prime” ruction that surfaced in August 2007 subsided in October-November. Another flare of increased force spread to the investment banking, commercial real estate and other sectors in January-March 2008 and dissipated in April-August. Finally, a panic of breadth and depth unseen in decades exploded in September-October.

This most recent detonation, whose consequences market participants may well be exaggerating,⁴ is associated with an unaccustomed struggle among many households and businesses to secure the cheap and easy credit to which they have become addicted. It is also startling people into the belated realisation that the “economic fundamentals” in the U.S., Western Europe and other places including Australia have actually been quite sick for quite some time and won’t return to health in a hurry. The present panic, like its predecessors, generates considerable day-to-day volatility of prices. A bear market, on the other hand, spawns a steadier downward grind. As a panic fades, volatility attenuates; but if a panic helps to trigger a recession, and a recession causes a bear market, then prices become less erratic but nonetheless slog lower for longer.

“As in every preceding crisis, the main cause was far too large a mass of credits – that is, of debts – for the amount of cash in which they were redeemable. Trade and speculation had long been so active, and too often recklessly expanded, that this disproportion had become dangerous, and a menace to our safety ... A

³ For details, see Ed Easterling, *Unexpected Returns: Understanding Secular Stock Market Cycles* (Cypress House, 2005) and Russell Napier, *Anatomy of the Bear: Lessons from Wall Street's Four Great Bottoms* (Harriman House, 2007).

⁴ See in particular [The Data Don't Justify Financial-Market Panic](#) by Robert Higgs.

serious reaction, a serious revulsion, was inevitable unless we moderated our pace and mended our ways. I could foresee that this vast and growing disproportion between the volume of credits and cash would finally lead to collapse.” Henry Clews wrote these words, describing the [Panic of 1907](#), exactly a century ago (see *Fifty Years in Wall Street* (John Wiley & Sons Investment Classics, 2006). Clews also investigated the American panics and crashes of 1812, 1819, 1825, 1837, 1857, 1873, 1881 and 1893. In each instance, he discovered, a boom built upon too little capital, too much debt and fevered speculation initially caused a financial panic and eventually produced an economic bust.⁵

Clews’ diagnosis is quite reasonable, but his prescription is utterly astonishing. How to still a panic and combat a bust? Enable or even force banks (solvent or otherwise) to lend even more, and encourage debtors (solvent or otherwise) to borrow yet more, than they had hitherto! Apparently, the cure of a hangover is yet another blinder; and the antidote to the drug addict’s withdrawal is an even stiffer dose of the narcotic that threatens his life. “In every panic very much depends upon the prudence and control of the money-lenders ... This is tantamount to saying that all depends on the calmness and wisdom of the banks.” Clews took great care to stipulate that “prudence and control” and “calmness and wisdom” do not imply any restriction of lending. Quite the contrary: he warned that “if [banks] lose their heads and indiscriminately refuse to lend, or lend only to the few unquestionably strong borrowers, the worst forms of [panic and bust will] ensue.”

Hoisting his proto-Keynesian colours, Clews also asserted that the business cycle is a natural and not a man-made phenomenon. “The action of commerce, like a motion of the sea or the atmosphere, follows an undulatory line. First comes an ascending wave of activity and rising prices; next, when prices have risen to a point that [limits] demand, comes a period of hesitation or caution; then, carefulness among lenders and discounters; then comes the descending movement, in which holders simultaneously endeavour to [withdraw their money], thereby accelerating a general fall in prices. Credit then becomes more sensitive and is contracted; transactions are diminished; losses are incurred through the depreciation of property; and finally the ordeal becomes so severe to the debtor class that forcible liquidation has to be adopted, and insolvent firms and institutions must be wound up.”

Explicitly disavowing that the business cycle is a man-made phenomenon, Clews implicitly rejected the possibility that fiscal or monetary policies, or underlying institutional arrangements, could launch or exacerbate it. Yet his prescription asserts that certain policies and arrangements can tame and extend (and perhaps even perpetuate) its “upward” leg. Although he wrote 100 years ago, Clews’

⁵ The most impressive theoretical and thorough analysis of a 19th century panic remains Murray Rothbard’s [The Panic of 1819: Reactions and Policies](#) (AMS Press, 1962). See also Rothbard’s *A History of Money and Banking in the United States: The Colonial Era to World War II* (Ludwig von Mises Institute, 2002). You say you’ve never heard of the Panic of 1819? As Lew Rockwell reminds us in [Don’t Trust the Brains Trust](#), that’s because the government did nothing about it, and therefore it departed as quickly as it arrived.

mindset is as current as this morning's newspaper: policies that expand borrowing and lending can do much good and no harm.⁶ Further, a cycle's specific path at a particular place and point in time is to a considerable degree the result of chance, luck and fate. Whatever happens, as long as the state is encouraging (and, if necessary, underwriting or even directly undertaking) borrowing and lending, then the bust isn't the state's fault.⁷

During the past century, this conception of the business cycle, its origin and the state's ability to influence it has hardly changed. Like the Bourbons, [mainstream economists](#), policy makers, journalists and market participants have learnt exactly nothing and forgotten precisely nothing. Then and now, whenever anything is the matter, the rallying cry is against "tight money" and for more and easier credit. It's scarcely an exaggeration to say that lower interest rates and more debt are miracle salves that will heal all wounds. And when the cat is really amongst the pigeons, as it was in the 1930s and as some are saying it is today, the enduring "lesson" is that the state must intervene pervasively and massively in order to avert an even worse fate. Above all, counsels the conventional wisdom, heaven and earth must be moved such that debtors evade the damaging consequences of their behaviour. Under no circumstances must they be allowed to default *en masse*. According to the best and the brightest, markets often fail but governments never do. Only the state and its "leaders" have the wisdom and wherewithal to halt a financial panic, "stabilise the system," correct capitalism's endemic faults and guarantee recovery.

Tight Monetary Policy and the Gold Standard Allegedly Exacerbated the Great Depression

The remarks of Ben Bernanke at the [Conference to Honor Milton Friedman's 90th birthday](#) (University of Chicago, 8 November 2002) epitomise the mainstream's diagnosis of – and its prescription to prevent and combat – panics and crashes. According to Bernanke, Friedman's greatest contribution to economic science "is nothing less than to provide what has become the leading and most persuasive explanation of the worst economic disaster in American history, the onset of the Great Depression – or, as Friedman and [Anna] Schwartz [the authors of *A Monetary History of the United States, 1867-1960*, University of Chicago Press, 1963] dubbed it, the Great Contraction of 1929-33."

⁶ A superb example of this epochal conceit appeared in *The Brisbane Times* ([Let the Good Times Roll: Howard](#), 17 October 2007). The Man of Steel said that, thanks to governments' economic reforms, Australia had enjoyed 16 years of uninterrupted growth, "and there was no reason it could not continue indefinitely." Giving the reporter the benefit of his amazing powers of prophesy, "Mr Howard, relaxed and confident in his Canberra office, said the Coalition had had 'a strong start' to its election campaign and could win. 'I'm very enthused and applied and confident ... Boom and bust is not the case now because we've had a series of economic reforms, all of which I have supported – even those that were promoted by my political opponents.'" Business leaders also succumbed to this delusion. The chief investment officer of one of Australia's largest financial institutions wrote less than a year ago in *The Australian*: "Those who say we live in a riskier, more volatile investment universe are wrong ... Risk is falling as a result of structural change ... As a result, the days of large boom and bust cycles are long gone, as are large swing cycles in interest rates from 5 to 15 per cent."

⁷ Alan Greenspan insists that the unfolding bust of 2007-2008 is certainly not his fault. See, for example, [Greenspan: It's Not My Fault](#) (*The New York Post*, 14 September 2007).

Unduly restrictive monetary arrangements and insufficiently “loose” monetary policies allegedly caused the collapse. In Bernanke’s words, Friedman and Schwartz “laboriously built the case that the causality can be interpreted as running (mostly) from money to output and prices, so that the Great Depression can reasonably be described as having been caused by monetary forces ... For the early Depression era, Friedman and Schwartz identified at least four distinct episodes that seem to meet these criteria. Three are tightenings of policy; one is a loosening ...” For the mainstream, the lesson is that “tight” monetary policy, and the resultant unduly high interest rates, helped to turn a severe slump into the Depression.

Not only was policy too tight; underlying monetary arrangements were also unduly restrictive. “Friedman and Schwartz’s [second] insight was that, if monetary contraction was in fact the source of economic depression, then countries tightly constrained by the gold standard should have suffered relatively more severe economic downturns. Although not conducting a formal statistical analysis, [they] gave a number of salient examples to show that the more tightly constrained a country was by the gold standard (and, by default, the more closely bound to follow U.S. monetary policies), the more severe were both its monetary contraction and its declines in prices and output.” The trouble with the gold standard, the mainstream alleges, is that it shackled monetary authorities and thus prevented them from intervening sufficiently forcefully during the Depression’s early stages. The Hoover Administration (which was allegedly laissez-faire and responded feebly to the slump) also made things much worse than they would otherwise have been.⁸

Speculators and Foreigners Took Our Gold and a Lack of “Leadership” Wrecked Our Banks

A striking feature of the Depression in the U.S. (as opposed, say, to Canada) was the extent of bank failures. During the 1930s, half of America’s commercial banks either failed or became so weak that mergers and takeovers became the only viable means to avert bankruptcy.⁹ Why did so many banks fail? Franklin Roosevelt said “there have been heavy and unwarranted withdrawals of gold and currency from

⁸ See also Ben Bernanke, [Money, Gold, and the Great Depression](#) (2 March 2004).

⁹ The crescendo of America’s banking crisis occurred when President Roosevelt signed [Proclamation \(2039\)](#), declared a Bank Holiday (from 6-9 March 1933 inclusive) and ordered that all of the nation’s banks be closed. No bank could transact any business without the permission of the Secretary of the Treasury, and for good measure the NYSE and other stock exchanges also closed. A second [Proclamation \(2040\)](#) extended the first one indefinitely, but “indefinitely” was soon changed to 13 March. The Emergency Banking Act became law on 9 March. Under its terms, the U.S. Government closed banks that it deemed to be insolvent and reorganised and reopened those it decided were strong enough to survive. It also gave to the Secretary of the Treasury the authority to confiscate the gold of private citizens in exchange for an equivalent amount of paper currency (which was later subjected to a massive devaluation with relation to gold). Despite the Act’s unprecedented terms, Congress passed it with immense haste. Few if any Congressmen had the chance to read the bill; most were only able to hear the clerk read a brief summary. Some vociferously protested the haste with which it was considered, but nevertheless passed it sight unseen.

our banking institutions for the purpose of hoarding; and speculative activity abroad in foreign exchange has resulted in severe drains on the Nation's stocks of gold."¹⁰ In Bernanke's words, Friedman and Schwartz contended that "under institutional arrangements that existed before the establishment of the Federal Reserve, bank failures of the scale of those in 1929-33 would not have occurred, even in an economic downturn as severe as that in the Depression. For doctrinal and institutional reasons, ... however, the extraordinary spate of bank failures did occur and led in turn to the massive extinction of bank deposits and an abnormally large decline in the stock of money."

Before the Fed's creation, private mechanisms – namely co-operation among banks – were usually able to quell panics. If a run on one or more banks commenced, a clearinghouse of neighbouring banks suspended its payments, i.e., temporarily refused to convert its deposits into cash. Larger and stronger banks would determine whether the bank(s) under attack was solvent, and if so would support or purchase it. Though hardly an entirely satisfactory solution,¹¹ the clearinghouse system usually prevented both the persistence of local panics and their spread into regional or national ones. Large and solvent banks had an incentive to join a clearinghouse because they knew that an unchecked panic might ultimately threaten their own deposits.

According to its proponents, the Federal Reserve System was created (in 1913) largely in order to improve the management of banking panics. But "as Friedman and Schwartz discuss in some detail, in the early 1930s the Federal Reserve did not serve that function. The problem within the Fed was largely doctrinal: officials appeared to subscribe to Treasury Secretary Andrew Mellon's infamous 'liquidationist' thesis, that weeding out 'weak' banks was a harsh but necessary prerequisite to the recovery of the banking system. Moreover, most of the failing banks were small banks (as opposed to what we would now call money-centre banks) and not members of the Federal Reserve System. Thus the Fed saw no particular need to try to stem the panics. At the same time, the large banks – which would have intervened before the founding of the Fed – felt that protecting their smaller brethren was no longer their responsibility. Indeed, since the large banks felt confident that the Fed would protect them if necessary, the weeding out of small competitors was a positive good, from their point of view."

In short, "because of institutional changes and misguided doctrines, the banking panics of the Great Contraction were much more severe and widespread than would have normally occurred during a downturn. Bank failures and depositor withdrawals greatly reduced the quantity of bank deposits, consequently reducing the money supply. The result, [Friedman and Schwartz] argued, was greater deflation and output decline than would have otherwise occurred."

¹⁰ This, like most of FDR's utterances, was diabolical propaganda and blatant nonsense. For the facts, see John T. Flynn, *The Roosevelt Myth* (Fox & Wilkes 50th Anniversary Edition, 1998, chaps. 2-3).

¹¹ The failure of unsound banks destroyed deposits, and suspension of payments for several weeks by troubled but sound banks imposed a significant hardship upon the public.

The Fed Must Command-and-Control and Have a Great Helmsman

The mainstream cites a final factor, namely the premature death of America's pre-eminent central banker in 1928, which allegedly helped to turn a slump into the Great Depression. Benjamin Strong, who was Governor of the Federal Reserve Bank of New York and the *de facto* equivalent to a Fed Chairman today, led the Fed throughout the 1920s. In Bernanke's view, "he had a strong personality and was a brilliant central banker. Quite plausibly, his personality and skills created a leadership position within a Federal Reserve System that – as suggested by its name – was intended by the Congress to be a relatively decentralized institution."

Bernanke continues: "After Strong's death, the Federal Reserve no longer had an effective leader or even a well-established chain of command. Members of the Board in Washington, jealous of the traditional powers of the Federal Reserve Bank of New York, strove for greater influence; and Strong's successor, George Harrison, did not have the experience or personality to stop them. Regional banks also began to assert themselves more. Thus, power became diffused; worse, what power there was accrued to men who did not understand central banking from a national and international point of view, as Strong had. The leadership vacuum and the generally low level of central banking expertise in the Federal Reserve System was a major problem that led to excessive passivity and many poor decisions by the Fed in the years after Strong's death." Bernanke concludes: "Friedman and Schwartz argued in their book that if Strong had lived, many of the mistakes of the Great Depression would have been avoided."

The Mainstream's "Lessons" of the Great Depression

For self-styled practical central bankers like Ben Bernanke, the mainstream's analysis as epitomised by Friedman and Schwartz "leaves many lessons. What I take from their work is the idea that monetary forces, particularly if unleashed in a destabilising direction, can be extremely powerful. The best thing that central bankers can do for the world is to avoid such crises by providing the economy with, in Milton Friedman's words, a 'stable monetary background.'"

Hence the mainstream's overarching lesson: buying and selling and borrowing and lending are simply too important, and capitalism is too inherently unstable and even chaotic, to leave to mere buyers and sellers in markets for goods, services, capital and labour. Instead, the state in general and its central bank in particular must "manage the economy." By intervening systematically in markets, and thus countermanding and "correcting" the signals of actors in these markets, agents of the state can restrain commercial activity in good times and to stimulate it in not-so-good times.¹² Indeed, politicians' and bureaucrats' adroit handling of the

¹² Murray Rothbard wrote in [Economic Depressions: Their Cause and Cure](#) that "the economy is treated as a potentially workable, but always troublesome and recalcitrant patient, with a continual tendency to hibernate into greater inflation or unemployment. The function of the government is to be the wise old manager and physician, ever watchful, ever tinkering to keep the economic patient in good working order ... It was not so long ago that this kind of attitude and policy was called 'socialism'; but we live in a world of euphemism ..."

economy's "levers" can greatly prolong and perhaps even perpetuate the upward leg of the business cycle. The lesson the mainstream has drawn from the Great Depression, in short, is that the state must protect people from the chaos and ravages of the free market. For central banks, this lesson contains five corollaries:

1. Under normal circumstances, they must constantly strive to increase the availability and reduce the cost of credit. This is because borrowers and lenders acting voluntarily in an unfettered market issue too little credit at an unreasonably high price.
2. Under abnormal conditions, the central bank must "flood the system with liquidity." This is because politicians and bureaucrats have decreed that a slump, downturn, recession, etc., is an undesirable event, and that the agents of the state have the wit to foresee and the power to prevent (or at least mitigate) it. More generally, politicians and bureaucrats must strive at all costs to attenuate or abolish the downward leg of the business cycle.
3. The central bank must strive mightily to abolish (and, once extinguished, never allow to return) restrictive and therefore lightly undesirable monetary arrangements like the gold standard.
4. It must become a centralised institution that can impose its policy uniformly across the country. Most importantly, the supply of credit and the role of "lender of last resort" must be monopolised into its hands.
5. The central bank must provide benign but firm "leadership" in normal times and commanding leadership in times of crisis – which in any event will be extremely rare (see Corollaries 1-4). In particular, a Great Man like Alan Greenspan must lead it. Such a man will inspire confidence, restore it when it is inexplicably lacking (re-read Corollaries 1-4) and, *in extremis*, act authoritatively to prevent the widespread collapse of confidence and the failure of a large number of banks.

Bernanke concluded with a chilling admission and a laughable promise: "Let me end my talk by abusing slightly my status as an official representative of the Federal Reserve. I would like to say to Milton and Anna: regarding the Great Depression, you're right, we did it. We're very sorry. But thanks to you, we won't do it again."

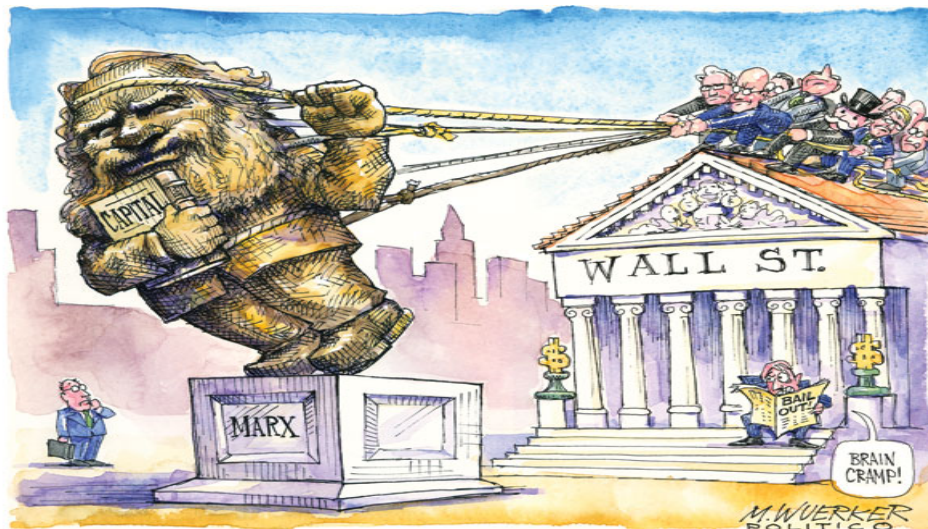
Friedman and Schwartz and Their Heirs: Dead Wrong about the Great Depression

In a superb article ([Bailout Marks Karl Marx's Comeback](#), *The Financial Post*, 20 September 2008), Martin Masse reminds us that, in the [Communist Manifesto](#), Karl Marx demanded the "centralisation of credit in the banks of the state, by means of a national bank with state capital and an exclusive monopoly."¹³ If he

¹³ The Manifesto's Big Ten Demands, quoted verbatim in all their absurdity and horror, are:

1. Abolition of property in land and application of all rents of land to public purposes.
2. A heavy progressive or graduated income tax.

were here today, Marx would presumably be astounded and delighted to discover that virtually all mainstream economists, financial commentators, business moguls, politicians and investors – never mind their free market rhetoric – are, in effect, staunch Marxists. Would Evil Karl be amused or bemused to learn that editorialists at *The Australian*, Britain’s *Financial Times*, Canada’s *Financial Post*¹⁴ and *The Wall Street Journal*, as well as businessmen like Rupert Murdoch and Warren Buffett and “conservative” politicians from George W. Bush to John Howard, are enthusiastic proponents of central banking? That they have supported the massive “injections of liquidity” by central banks since August 2007, as well as the confiscation by the Leviathan-Within-the-Beltway of giant financial institutions in September 2008? They even supported the [October Revolution](#) (a.k.a. the [Emergency Economic Stabilization Act of 2008](#) or the [Bailout of Abominations](#)). “Truly”, Marx might exult, “just as Ludwig von Mises prophesied it would, Communism has collapsed in Europe, the USSR and Red China. But thanks to mainstream economists, businessmen, politicians and journalists, key planks of the Communist Manifesto are thriving in the West!”



When their usual combination of mumbo-jumbo, spin, smokescreens and bribes

3. Abolition of all rights of inheritance.
4. Confiscation of the property of all emigrants and rebels.
5. Centralisation of credit in the banks of the state, by means of a national bank with state capital and an exclusive monopoly.
6. Centralisation of the means of communication and transport in the hands of the state.
7. Extension of factories and instruments of production owned by the state; the bringing into cultivation of waste lands, and the improvement of the soil generally in accordance with a common plan.
8. Equal obligation of all to work. Establishment of industrial armies, especially for agriculture.
9. Combination of agriculture with manufacturing industries; gradual abolition of all the distinction between town and country by a more equable distribution of the populace over the country.
10. Free education for all children in public schools. Abolition of children’s factory labour in its present form. Combination of education with industrial production, etc.

¹⁴ Actually, it’s possible that the *FP* is beginning to see the light. See, for example, Terence Corcoran’s [Financial Markets Go Up and Down as They Should](#). Also refreshing is Joel Stein’s [Bailout? Just Do Nothing](#).

doesn't do the trick, the establishment resorts to groundless fears and brazen lies. "The whole history of the [U.S.]," wrote the great H.L. Mencken in *Notes on Democracy* (1926), "has been a history of melodramatic pursuits of horrendous monsters, most of them imaginary: the red-coats, the Hessians, the monocrats, again the red-coats, the Bank, the Catholic, the slave power, Jeff Davis, Mormonism, Wall Street, the rum demon, John Bull, the hell hounds of plutocracy, the trusts, ... Pancho Villa, German spies, the Kaiser, Bolshevism. The list might be lengthened indefinitely: a complete chronicle of the Republic could be written in terms of it, without omitting a single important episode."

To this list we can add Saddam Hussein and a repeat of the Great Depression. The Bush regime, in other words, has mastered the dark art of concocting fantasies that frighten its subjects into submission. "The risks of doing nothing far outweigh the risks of whatever it takes to disarm Saddam Hussein," [said the Frat Boy](#) on 10 February 2003. And "the risk of doing nothing far outweighs the risk of the [\$700 billion-plus bailout] package," [he said](#) on 30 September 2008. Upping the ante, [he added](#): "I recognise this is a difficult vote for members of Congress. Many of them don't like the fact that our economy has reached this point, and I understand that. But the reality is that we are in an urgent situation, and the consequences will grow worse each day if we do not act."¹⁵

Indeed, the establishment and its spineless lackeys at the Big End of Town and in the mainstream media have been threatening the benighted such that, unless the anointed get their way, a repeat of the Great Depression beckons.¹⁶ They seem to regard this manoeuvre as a trump card that simply precludes any response. Masse links this threat to its source: "If we let too many institutions fail because of insolvency, we are being told, there is a risk of a general collapse of financial markets, with the subsequent drying out of credit and the catastrophic effects this would have on all sectors of production. This opinion, shared by Ben Bernanke, Henry Paulson and most of the right-wing political and financial establishments, is based on Milton Friedman's thesis that the Fed aggravated the Depression by not pumping enough money into the financial system following the market crash of 1929."

This claim is as empty as the assertion that Saddam Hussein possessed WMDs or

¹⁵ America's mainstream media enthusiastically swallowed the regime's lies about Saddam, and, true to its supine form, are parroting its lies about the Bailout of Abominations. According to *The Wall Street Journal* (2 October), it "isn't what we would have drawn up ... But it is one more policy tool at a time when something needs to be done. Passing it by itself won't by itself revive the banking system, but defeating it will guarantee far more damage to far more Americans." Stephen Ellis ([Like Iraq, Bush Bailout Aims at Wrong Target](#), *The Australian*, 26 September) stands proudly to the side of this phalanx of journalistic disgrace.

¹⁶ In Sydney on 25 September, in front of an audience of over 850 people at the Australia-Israel Chamber of Commerce, the head of one of Australia's Big Four banks said this quite explicitly. "Congress has got to understand exactly how important this is and how important it is to the US economy ... There is no choice and, you know, this is a plan to stabilise the system and I don't think it's got another one. This is it." (Questioner) "Look, if it's not passed, have we got a depression on our hands?" (Big Bank CEO) "Yeah." (Questioner) "No doubt about that?" (Big Bank CEO) "Absolutely."

that “terrorism” is anything other than a minor nuisance. Friedman was largely but not completely incorrect. During the 1920s and 1930s, the Fed’s policies were indeed utterly misguided, and they did indeed help to turn a slump into the Great Depression. But they did so in a manner that utterly escapes the mainstream. Friedman was flatly wrong about the gold standard.¹⁷ He was also totally mistaken about the Fed’s policies. As Murray Rothbard demonstrates in [America’s Great Depression](#) (also published in 1963), throughout 1929 (and as it had done since ca. 1921) the Fed inflated the supply of money (see chaps. 4-5). As in the decade since the mid-1990s, so too in the late 1920s: a relatively quiescent price level lulled central bankers into complacency (chap. 6). After Herbert Hoover entered the White House the inflation continued, and it remained throughout his term (chaps. 8-9, 11). Moreover, to say that Hoover was a paragon of *laissez-faire* who did nothing to combat the slump is totally wrong: Hoover had long been and as President remained an arch-interventionist (chaps. 7, 10-11).

The Fed, a creature of the state, together with the government’s myriad other crazed interventionist policies and damaging regulations, exacerbated rather than attenuated the bust. *The U.S. Government in general and the Fed in particular caused so much damage not because they did too little, but because they did too much of all the wrong things.* The Depression, in other words, was not a failure of *laissez-faire* capitalism: it was a failure of the hyper-interventionist state.¹⁸ Hence the Friedmanites (also called “monetarists”), Chicago Schoolies and other allegedly “free market” economists have learnt the diametrically incorrect lesson. They insist that the supposed “need to respond” and “do something,” to “inject liquidity” and “provide confidence” and “support the market,” overrides the concern they mouth in normal times about the dangers of inflation and other intervention in the market. Friedmanites and their associates, in other words, are mere rhetorical or “fair-weather” free marketeers. Whenever something is really the matter, and when the state’s intervention greatly worsens that something, they cut and run and join the Keynesians, Marxists and who knows what other enemies of liberty and prosperity.¹⁹

¹⁷ Essentially, Friedman hopelessly confuses the classical gold standard of the 19th century with the gold-exchange standard of the 1920s. These were utterly different things. For a summary, see three of Murray Rothbard’s books published by the Ludwig von Mises Institute: *The Case Against the Fed* (1994), *The Case for a 100 Percent Gold Dollar* (1991) and [What Has the Government Done to Our Money?](#) (1963).

¹⁸ In addition to Rothbard, which is the best theoretical and empirical analysis by far of the Depression, essential reading includes Benjamin Anderson, *Economics and the Public Welfare: A Financial and Economic History of the United States, 1914-1946* (Liberty Press, 1979); Thomas DiLorenzo, *How Capitalism Saved America* (Crown Forum, 2004); Garett Garrett, *Salvos Against the New Deal: Selections from the Saturday Evening Post 1933-1940* (Caxton Press, 2002); Ludwig von Mises, *The Causes of the Economic Crisis and other Essays Before and After the Great Depression* (Ludwig von Mises Institute, 2006); Jim Powell, *FDR’s Folly: How Roosevelt and His New Deal Prolonged the Great Depression* (Crown Forum, 2003); Gene Smiley, *Rethinking the Great Depression: A New View of Its Causes and Consequences* (Ivan R. Dee, 2002).

¹⁹ A similar phenomenon appears in the realm of foreign relations. “Liberventionist” is a term coined by [paleolibertarians](#) to describe alleged “libertarians” who in the name of “freedom” in America promote lying, cheating, stealing and mass murder in foreign lands. See, for example, [Life, Liberty and the Pursuit of World War](#) by Anthony Gregory.

Contrary to the view of most mainstream economists, Milton Friedman never was a foe of inflation: he simply wanted to keep it under “better control” in “normal circumstances.” To that end, he famously proposed that the Fed’s leading lights be replaced with a computer that, come what may, would increase the supply of money at a constant percentage rate over time.²⁰ In short, Friedman’s assertion that the Fed didn’t intervene during the Depression is simply wrong. It intervened mightily – and those interventions, and not the lack thereof, helped to transform a slump into a Great Depression. Similarly, the assertion that Herbert Hoover sat on his hands is demonstrably incorrect. Like Franklin Roosevelt, whose New Deal was a mere intensification of Hoover’s policies, he taxed, spent, intervened, subsidised and protected on a massive scale – and those derangements of market signals also helped to transform a slump into a Great Depression.²¹ This is a key difference between the Austrian School’s and the mainstream’s interpretation of the Depression. The Austrians conclude that the state must step aside; the mainstream insists that it must intervene in every way imaginable and with every weapon at its disposal.

The result is that the policy prescription of today’s mainstream is as absurd as Clews’ was a century ago. Martin Masse rightly concludes: “The confusion of [mainstream] economics on monetary issues is so profound as to lead its adherents today to support the largest government grab of private capital in world history. By adding their voices to those on the left, these confused free-marketeers are not helping to ‘save capitalism’, but contributing to its destruction.” If they are determined to shove a central tenet of Marxism down our throats, why don’t they come out of the closet and honestly and openly profess it?

Hume and Ricardo Knew What Utterly Escapes Today’s Mainstream

It’d be laughable if it weren’t pathetic: the conception of the business cycle that has prevailed since the early 20th century – and which rules the roost in Australia, Britain, Canada the U.S. and elsewhere – owes most to Karl Marx. He saw that, before the Industrial Revolution, no general pattern of economic boom and bust had occurred.²² These cycles appeared on the scene at about the same time as factories and industrialisation. Hence Marx – who was hardly the first to confuse causation and correlation – erroneously concluded that business cycles were an inherent feature of capitalism.

²⁰ See, for example, Peter Robinson, [What Would Milton Friedman Say to Ben Bernanke?](#)

²¹ For solid analyses of Franklin Roosevelt’s malevolence and the catastrophes, foreign and domestic, he wrought, see John Denson, *A Century of War: Lincoln, Wilson & Roosevelt* (Ludwig von Mises Institute, 2006), Thomas Fleming, *The New Dealers’ War* (Basic Books, 2001) and John T. Flynn, *The Roosevelt Myth* (Fox & Wilkes, 1948).

²² True, economic crises often erupted when a king suddenly made war or confiscated more than his usual quota of his subjects’ property; but before the 18th century there was no sign of general and fairly regular expansions and contractions of financial and economic fortunes.

Apart from the Austrian School, *all* of today's various schools of economic thought, regardless of their many differences, affirm this vital point: the business cycle originates somewhere deep within the bowels of the market economy. Marx believed that periodic depressions would get worse and worse until the masses would revolt and overthrow capitalism. Today's political and economic mainstream, on the other hand, believes that the state can successfully manage the cycle's ups and downs – and when things really go awry, the state must intervene massively and will ride successfully to the rescue. Albeit for very different reasons, both Marxists and mainstreamers agree that free markets are unstable.

Unfortunately for today's mainstream, some intractable problems accompany the assumption that the market economy triggers the business cycle. Perhaps most notably, because economists simply do not bother to reconcile their theories of the business cycle and of the price mechanism, they have long been utterly baffled by the peculiar breakdown of the entrepreneurial function at times of economic crisis.²³ In the market economy, one of the most vital tasks of the businessman is to act as an “entrepreneur” – that is, a man who buys equipment and hires labour in order to produce something that he intends (but cannot be sure) will reap him a return that outweighs his risk. In short, the function of the entrepreneur is to forecast an inherently uncertain future. Before embarking upon any investment or line of production, he must estimate present and future costs and present and future revenues – and therefore how much profit he might earn. If he forecasts significantly better than his competitors, he will reap substantial profits. The better his forecasts, the higher will be his profits. If, on the other hand, he overestimates the demand for his good or service, he will not fulfil his plans and may suffer losses. And if his losses are sufficiently severe, he will face bankruptcy, cease production and exit the market.

The market economy thus contains a built-in mechanism, a kind of natural selection, which ensures (i) the survival and prosperity of the superior forecaster and (ii) the failure and extinction of the inferior one. This culling occurs gradually over time. Accordingly, at any given point in time we would expect that relatively few businesses would be incurring losses. Hence the very odd fact that demands explanation: how is it that, the business world periodically and suddenly suffers a cluster of severe losses? Why does the moment arrive when businessmen, who on the whole had hitherto been highly astute entrepreneurs, abruptly become dunces?

²³ The basic laws of supply and demand – whose existence not even Marx denied! – demonstrates that in the market supply and demand always tend towards equilibrium, and that therefore that the prices of end products as well as of the factors of production are always tending towards equilibrium. Although changes of data, which are always taking place, prevent the actual occurrence of equilibrium, there is nothing in the general theory of the market system that would account for regular and recurring boom-and-bust phases of the business cycle.

Most economists “solve” this problem by keeping their general price and market theory and their business cycle theory in separate and even watertight compartments. Never are the two juxtaposed; and less still less is one rendered logically and empirically consistent with the other. Alas, economists have forgotten that there is only one economic reality, and therefore that there is room for just one integrated economic theory. Yet most economists are content to apply totally separate – and, indeed, mutually exclusive – theories for general price analysis and for business cycles.

Clearly, an adequate theory of the business cycle must explain the tendency, which has been observed time after time, of the economy to move from boom to bust and back to boom. It must explain why the modern world shows no sign of settling into any reasonable facsimile of a smoothly moving approximation of an equilibrium situation. In particular, such a theory must account for the mammoth cluster of errors which appears suddenly at a moment of economic crisis, and lingers through the bust (or recession, depression, etc., according to your preferred term) period until recovery.

Fortunately, a correct theory of the business cycle *does* exist, even though today's economists either ignore resolutely it or are blithely ignorant of it. This is inexcusable, for this theory is grounded deeply within – and has a long and honourable tradition in – economic thought. The theory owes its origins to the late-18th century Scottish philosopher and economist David Hume and the early-19th century English classical economist David Ricardo. Hume and Ricardo saw what Marx did not, and what his heirs in today's mainstream will not: namely that another crucial institution rose to prominence alongside the factory, industrial and capitalist system in the mid-18th century. This was the fractional-reserve bank and its capacity to expand credit and the supply of money (first in the form of paper money or bank notes, and later in the form of demand deposits, a.k.a cheque accounts, that are instantly redeemable in cash at the bank). Hume and Ricardo understood that the operations of these banks held the key to the mysteriously recurring cycles of expansion and contraction, of up and down and boom and bust, and profit and loss, that had first appeared in and had puzzled observers since the mid-18th century.

The Humeian and Ricardian conception and analysis of the business cycle has several hallmarks. First, the natural moneys that emerge on the free market are useful commodities – generally gold and silver. If money were confined simply to these commodities, then the economy would work in the aggregate much as it does in unfettered markets: a smooth adjustment of supply and demand, and therefore no cycles of boom and bust. But the injection of bank credit adds a crucial and disruptive element. The banks expand credit in the form of notes or deposits which are theoretically redeemable on demand in gold, but in practice clearly are not. Fractional reserve banks, in other words, are inherently bankrupt (see also [Letter 102-104](#)).

For example, if a bank has 1000 ounces of gold in its vaults and it issues instantly-redeemable warehouse receipts for 2500 ounces, then it has obviously issued 1500 ounces more than it can possibly redeem. Consequently and equally clearly, this bank is insolvent. But so long as there is no concerted “run” on its deposits, i.e., no sudden and massive demand to exchange these receipts for gold, its warehouse-receipts function on the market as an equivalent of gold, and therefore the bank can expand (inflate) the country's money supply by 1500 ounces of gold.

Realising that the more they expand credit the greater will be their profits, the banks happily begin to inflate. As the supply of paper and bank money within a

country (say, England) increases, the incomes and expenditures of Englishmen – and the prices of English goods – rise. The result of fractional reserve banks' inflation is a boom within the country. But this boom sows the seeds of its own demise. For as the supply of money and incomes in England increases, Englishmen tend to purchase more goods from abroad. Moreover, as English prices rise, English goods begin to lose their competitiveness vis-à-vis the products of other countries which have not inflated, or have been inflating to a lesser degree. Englishmen begin to buy relatively less at home and comparatively more abroad, whilst foreigners buy less in England and more at home; the result is a deficit of the English balance of payments.

But if imports exceed exports, then money must flow from England to foreign countries. And what money will this be? Probably not English banknotes or deposits, for Frenchmen or Germans or Italians have little desire to retain their funds in Perfidious Albion. These foreigners will therefore take their notes and deposits and present them to the English banks for redemption into gold. Hence gold will be the type of money that will tend to emigrate as the English inflation proceeds. But *this means that English bank credit will be ever more precariously pyramiding atop a dwindling base of gold in the English bank's vaults.* As the boom proceeds, our hypothetical bank will expand its warehouse receipts issued from, say 2500 ounces to 4000 ounces, while its gold base dwindles to, say, 800. This bank, in other words, becomes ever more highly leveraged.

As this process intensifies, this bank – and other banks that do business with it – will become frightened. Their problem is that they must redeem their notes for gold; yet this bank's stock of gold is dwindling. Hence the banks will eventually lose their nerve, stop their expansion of credit and, in order to save themselves, contract their volume of loans outstanding. Often, this retreat is precipitated by runs on some banks (usually but not invariably the most heavily-leveraged) by panicked members of the public, who had also been getting increasingly nervous about the banks' ever more shaky condition.

This contraction of credit reverses the economic picture: retrenchment and bust inevitably follow inflation and boom. The banks pull in their horns, and businesses suffer as the pressure mounts for the repayment of debt and downward pressure upon the prices of English goods and services mounts. As the prices of English goods and services decrease, they become relatively more attractive in terms of foreign products, and the balance of payments gradually reverses itself. As gold flows into the country, and as bank money contracts on top of an expanding gold base, the condition of the banks becomes sounder.²⁴

²⁴ Note carefully the discipline which a genuine gold standard – even when corrupted by fractional reserve banking – imposes upon banks, businesses and consumers. It is precisely this innate discipline that provides its ultimate and unassailable justification – and explains why politicians, central bankers and their shills in the universities and mass media despise sound (i.e., gold-based) money. One of its many virtues is that it renders total war economic unviable – which is precisely why a genuine gold standard was junked during the First World War, and why it has never returned.

Hence the vital importance of the depression phase of the business cycle generated by fractional-reserve banking. *It is not something to be avoided at all costs: rather, it is an inevitable consequence of the preceding expansionary boom, and is a necessary condition of a return to economic health.* The preceding phase of boom makes necessary the subsequent phase of bust. During the depression, the market economy adjusts, removes the excesses and distortions of the previous inflationary boom and re-establishes a sound economic base. The depression is the disagreeable but indispensable reaction to the distortions and excesses of the boom. It is the hangover the drunk must suffer and the cold-turkey the addict must endure.

Why, then, does the next cycle begin? Why do business cycles tend to recur? When fractional-reserve banks return to a sounder condition, they can resume their fraudulent *raison d'être*, namely the expansion of credit backed by thin air rather than genuine savings. The next boom is thus ignited, which sows the seeds for the next bust. But if fractional-reserve banking causes the business cycle, and if banks are a legitimate part of a free market economy, can't we still say that the free market is the culprit? No. If not for the intervention and encouragement – indeed, the protective legislation – of government, the fractional reserve banks within a country would never be able to expand credit in concert. For if banks were truly competitive, any expansion of credit by one bank would quickly accumulate on the balance sheets its competitors, and these competitors would promptly call upon the expanding bank for redemption of this credit into gold. In short, a bank's rivals will call upon it to redeem in gold in the same way as do foreigners, except that the process is much faster and would nip any incipient inflation in the bud before it proceeded very far.²⁵

In short, the fractional-reserve banks within a country can only inflate in unison when a central bank exists to cover their backs. Such a bank typically decrees the terms and conditions of the fiat currency, enjoys a monopoly of government business and also exercises a privileged position (imposed by government) over the entire banking system. It is only when central banks became established in major countries, and connived with fractional-reserve banks to inflate the money supply, that the banks were able to inflate for any length of time and the business cycle established itself. *Hence the business cycle derives not from any failing of the free market, but from the systematic and pervasive intervention by the state into markets for money and credit.* Government intervention, not *laissez-faire*, generates inflation and the expansion of credit; and when the inflationary boom ends, the depression-adjustment arrives. The state is not just the doting father of the boom: it is also the absentee parent of the bust.

Mises, the Modern Austrians and the Correct Cure for Busts

The Hume-Ricardo theory is essentially correct. But it leaves several features of the cycle unexplained or incompletely explained. Building upon Hume and

²⁵ For details, see Lawrence White, *Free Banking in Britain: Theory, Experience and Debate, 1800-1845* (Institute of Economic Affairs, 1995).

Ricardo, the Austrian economist Ludwig von Mises developed the correct and fully developed (in the sense that it subsumes more reality than any other, and is more consistent with the real world than any other) theory. Hints of Mises' eventual solution to the puzzle of the business cycle first appeared in *The Theory of Money and Credit* (1912). Mises extended and elaborated his theory during the 1920s, and perfected it in his monumental treatise *Human Action* (1949). Friedrich von Hayek, who left Vienna to teach at the London School of Economics in the early 1930s, brought Mises' theory of the business cycle to the attention of the English-speaking world.²⁶ Hayek was Mises's leading disciple, and published two books which applied and elaborated Mises's theory: *Monetary Theory and the Trade Cycle* (1933) and *Prices and Production* (1935). Because Mises and Hayek were Austrians, and also because they advanced the tradition of the great 19th century Austrian School economists, this theory has become known as the "Austrian" theory of the business cycle.²⁷

What does Mises reckon the government should do once the unavoidable bust, recession or depression arrives? If it genuinely desires that the country emerges as quickly as possible from a recession, what role should the government play? First, the central bank must cease its policy of inflation. It's true that this will hasten the boom's demise (if the fears of commercial banks haven't killed it already). But the longer the government and the central bank wait, the worse the readjustment will have to be. The sooner they and everybody else face the music, the better.²⁸

²⁶ If it weren't tragic, it would be absurd: the Austrian (or Austrian-inspired) economists of the 1930s offered far more logically and empirically rigorous accounts and explanations of the Great Depression than do today's mainstream. See in particular Constantini Bresciani-Turroni, *The Economics of Inflation: A Study of Currency Depreciation in Post-War Germany* (John Dickens & Co., 1937); C.A. Phillips *et al.*, *Banking and the Business Cycle: A Study of the Great Depression in the United States* (Macmillan, 1937); Lionel Robbins, *The Great Depression* (Macmillan, 1934); Wilhelm Röpke, *Crises and Cycles* (William Hodge and Co., 1936); and Richard von Strigl, *Capital and Production* (Julius Springer, 1934).

²⁷ See also [Hayek on the Business Cycle](#) by Joseph Salerno. For further evidence corroborating the theory, see Barry Eichengreen and Kris Mitchener, [The Great Depression as a Credit Boom Gone Wrong](#) (Bank of International Settlements Working Paper No. 137, 2003); Paul Kasriel, [All We Are Sayin' Is Give Free Markets a Chance](#) and [The US Economy: A Textbook Austrian School Business Cycle?](#) and J.P. Keeler, [Empirical Evidence on the Austrian Business Cycle Theory](#) (*Review of Austrian Economics*, 2001). Also worth studying is the debate between Joseph Salerno (a defender of the theory) and Gordon Tullock (a critic). See Tullock's [Why the Austrians Are Wrong About Depressions](#). *Review of Austrian Economics* (1988), Salerno's [Comment on Tullock's "Why Austrians Are Wrong About Depressions"](#) *Review of Austrian Economics* (1989) and Tullock's [Reply to Comment by Joseph T. Salerno](#) *Review of Austrian Economics* (1989).

²⁸ A good analogy is with a forest and fires. If nature is left undisturbed, then the detritus which accumulates on the forest floor will occasionally (say, every couple of years) alight. Yes, these fires destroy some young trees and some wildlife; yet they also release nutrients into the soil and thereby set the stage for regeneration. Human intervention into this natural state of affairs typically has perverse consequences. When well-meaning people actively prevent the occurrence of natural fires, then the detritus on the forest floor eventually builds to unnatural and dangerous levels. And when it finally (say, after a couple of decades) ignites, the fire is often severe enough to destroy most of the wildlife and trees. So too with the "managed economy." By refusing to allow junk on the forest's floor to alight, that is, by attempting to abolish the bust phase of the business cycle, well-meaning interventionists allow malinvestments to accumulate. But eventually they do ignite, and the rarer but much more severe conflagration (depression) causes much more damage than the more frequent but shorter busts would have. Today's mainstream boasts that present arrangements are

Second, the government must never try to support unsound businesses; it must never “bail out” or “rescue” or lend money to or otherwise “support” businesses that find themselves in trouble. To do so is simply to prolong the agony and to convert an acute-but-transient condition into a lingering and chronic disease such as that which Japan has endured for most of the years since the late-1980s. Similarly, the government must never try to uphold wage rates or prices of goods and services or of stocks or bonds or real estate. These interventions will simply delay, prolong and correct the depression-adjustment.

A third and closely-related point is that the state must not, in a misguided attempt to evade or short-circuit or otherwise lessen the harsh but necessary effects the depression, try to reflate. *In other words, it must not continue to suppress interest rates below the level that would prevail in an unfettered market.* Even if this reflation temporarily “stimulates the economy,” it will simply brew greater trouble down the track. The government must not encourage consumption, particularly debt-financed consumption, and it must not increase its own spending, for this will further derange the appropriate ratio – which can only be discovered by individuals acting in free markets – between consumption and investment. *The state, in other words, must completely disavow “fiscal stimulus packages.”* Drastically cutting the government budget and slashing taxation will improve the ratio; so too will eliminating as many regulations as possible. In short, and in order to purge the misguided “malinvestments” of the boom, what both consumers and producers require is not more consumption and debt, but more saving and retrenchment.

What the government should do, according to the Misesian analysis, is – apart from trim its own sails, clean its own stables and reduce the burdens it imposes upon its subjects – absolutely nothing. It should, from the point of view of economic health and for the sake of ending the depression as quickly as possible, maintain a strict hands-off or *laissez-faire* policy. Any intervention into – and thus bastardisation of – the market, any derangement of market signals and the information they convey, will simply delay and obstruct the process of adjustment. The less the government tries to do, and hence the less damage it consequently does, the more rapidly will individuals be able to adjust to the reality the government had tried to deny and obey the natural laws of economics the state had presumed to flout, and quicker and the sounder the economic recovery that will ensue.²⁹

The Misesian prescription is thus the exact opposite of the mainstream (interventionist) one. The government’s task is to keep its clumsy hands off the economy, and to confine itself to stopping its own inflation, eliminating its stupid and harmful regulations and cutting its bloated budget.

“stable.” Alas, they do not realise that they are not stable: they are merely artificial.

²⁹ See also Michael Rozeff, [Depression Mitigation](#) and Martin Masse, [Let the Recession Run Its Course](#).

Bernanke, Paulson and All the Rest Are Ignoring Mises and Thereby Repeating the Interventionist Follies of the 1930s

Mainstream economists believe that they understand the causes of the Great Depression, that they have learnt appropriate lessons and therefore that they will be able to thwart its repetition. Indeed, they believe that they can anticipate and prevent the recurrence of severe recessions like those that plagued the 1970s and 1980s. “The great advantage that today’s policymakers enjoy over their predecessors 75 years ago,” declared Gerard Baker in *The Australian* ([Politicians May Be Repeating Mistakes of Past](#), 2 October) “is they have the benefit of learning the lessons from that disastrous experience. The only question is: will they?”

Misconceptions About Prices in the 1930s Are Spawning Damaging Bailouts Today

It is not because politicians and their lackeys are *avoiding* the mistakes of the past, but because they are *repeating* them, that history may rhyme. As in the 1930s, so too today: the best and brightest presume to know better than the mass of producers and consumers; they are resolutely refusing to allow free markets and prices to prevail; and as a result they are making things worse rather than better.



In *The Roosevelt Myth*, John T. Flynn devoted a chapter to “the dance of the crackpots” – that is, to the crackpot economic ideas in vogue within the Beltway in the early 1930s. Both Herbert Hoover and FDR adopted one of these crazy ideas as the foundation of their economic policy. Like Hoover, Roosevelt and his “braintrust” utterly misdiagnosed the Depression’s cause. Indeed, they confused cause and effect. Both believed that low prices and wages and the resultant “under-consumption” caused the Depression. (The truth is that the Depression caused prices and wages to fall.) The key to recovery, they thought, was policies that placed a floor under prices and wages, and which encouraged them to rise.

The result, of course, was disaster: to force wages to rise is to force the demand for labour to fall – and hence to increase unemployment. Similarly, any attempt to force prices higher crimps the demand for goods and services. On the day Herbert Hoover entered office, 1 million Americans were jobless. When FDR became president four years later, 8 million sought work, and after two four-year terms, 10 million were unemployed. When Hoover became president, Americans' personal consumption expenditure totaled \$79 billion; when he left it had fallen to \$46 billion; after FDR's first term it rose to \$63 billion and after his second term it stood at \$72 billion. Clearly, in 1940 America had still not recovered from the Depression, and recovery had to wait until *after* the Second World War.³⁰

But there's nothing new in the world except the history you don't know. "It's becoming clear," said the Australian "strategist" of a major financial institution on 30 September, "that the only white knight with deep enough pockets [to quell the panic] is the public sector." Also on that day, Poindexter urged American politicians to "take whatever action is necessary to ensure stability." AAP quoted him: This [the Bailout of Abominations] is the right measure for the Americans to be introducing right now to stabilise, frankly, the cornerstone of global financial markets ... When I was in the United States I called upon both Democrats and Republicans to support it."³¹

The editorialists of *Der Murdochischer Beobachter*, also known as *The Australian* (26 September) concurred. "There is no alternative to the bailout," they intoned, because "it significantly increases the chance that the U.S., and the rest of the world, can avoid financial catastrophe. Indeed, the price of doing nothing, as Mr Bernanke points out, would be far greater ... Doing nothing would likely precipitate a prolonged, deep recession – or even a depression – the rest of the world including Australia, has a deep, abiding interest in the bailout proceeding as smoothly and efficiently as possible." Alan Greenspan and George Schultz also agreed: "We endorse all plans that would preserve the key functions of threatened financial institutions. We do not advocate any particular program for restoring confidence in those institutions, but we are aware that the traditional approach has succeeded in heading off crises in the U.S. and other advanced countries. We do not take a stand on the choice of institutions eligible for emergency assistance. Rather, we urgently advocate immediate extensive action that would maintain the functions of credit markets and prevent a serious economic contraction."³²

³⁰ It is utterly absurd to contend, as most mainstream economists do, that the Second World War ended the Great Depression. For full details, see Robert Higgs, *Depression, War and Cold War: Studies in Political Economy* (Oxford University Press, 2006).

³¹ On 12 October, Poindexter announced that "Australia will guarantee all bank deposits for three years and will also guarantee wholesale funding to Australian banks in an attempt to combat the global credit crisis." Making good his vow to "take whatever action is necessary to ensure stability," Rudd also guaranteed the sanctity of all Australian marriages, the happiness of all Australian childhoods and the success of all Australian careers. Only good things ever happen in The Lucky Country!

³² Bless him, the president of the Federal Reserve Bank of Dallas, Richard Fisher, implicitly rebuked The Old Obfuscator on 25 September. "We need to keep in mind that the [Bailout of

The Australian establishment evinced little doubt that the bailout would succeed. “The package” will revive global financial markets and restore “global confidence.” “This is exactly what the market needs,” babbled one prominent economist. “If [the package] floods the market with liquidity, then it gets everything moving again ... I do think this is a positive step because you normally find that when markets are cheap and when governments are bailing things out and flooding the market with cash, then we are at the bottom in the U.S. ... The deal is a lifeline for equities and credit markets to restore momentum in the stability of the financial system” (*The Australian*, 29 September).

According to *The Weekend Australian* (4-5 October), “the government’s hope is that by taking the toxic assets off the books of banks and other financial companies, confidence will be restored and credit will start flowing again.” The Treasury will buy bad debts from banks (or perhaps will buy their equity); the banks will use the proceeds to repair their balance sheets; and having done so, and perhaps with the government’s guarantee of loans in hand, they will lend – and thereby support the price of residential real estate. In the meantime, the bad debts purchased by the Treasury will recover, enabling it to sell them at a profit down the road. A leading commentator said on 29 September: “the package is designed to put a floor under the debt of U.S. institutions. It removes the risk of a systemic collapse in the global financial system.” On 6 October, *The Australian* was less certain than it was the previous week. Still, the “bailout ... was essential ... [It] is all about providing credit to enable banks to recapitalise and extend credit to businesses and home buyers in the real economy ... [It] is not ‘a magic bullet’ but will help restore confidence by giving the U.S. Government the capacity to put a floor under the system.”

In the Middle Ages, alchemists purported to transform lead into gold: today, conjurers at the U.S. Treasury contend that they can transform bad debts (which fetch low prices) into good ones (which will command higher prices). Yet anybody who has a rudimentary knowledge of the price system – it seems that the heads of the U.S. Treasury and Federal Reserve, Alan Greenspan, the Prime Minister of Australia and the editorialists of *The Australian* do not – can readily understand that the October Revolution is utterly absurd. Like all other interventions by the state into the market, it will fail to achieve its objectives and will spawn a swarm of negative unintended consequences.

Abominations] places one more straw on the back of the frightfully encumbered camel that is the federal government ledger. Foremost among the existing liabilities are some \$13 trillion in unfunded Social Security benefits and Medicare obligations already promised to the people but as yet unfunded, an obligation that the Dallas Fed estimates at a present value of over \$80 trillion.” Also, three cheers to Robert Lucas and two other Nobel Laureates. In a [letter](#) to Congress, they and 164 other academic economists opposed the Bailout of Abominations because it subsidises business, is ambiguous and will have adverse consequences over time. They also expressed alarm at the unseemly haste of lawmakers and the Bush administration to pass the legislation. Jeffrey Miron, a Harvard University professor and self-described libertarian, advocates allowing the normal process of business failure and bankruptcy to run its course. “It’s just nothing like the calamity the administration is making it out to be,” he told Bloomberg.

The glorious Lew Rockwell, in [The \(Near\) Death of the State](#), reminds us that falling prices are good news, not bad (for buyers can stretch their dollars further), and that governments' futile attempts to control prices invariably produce more harm than good. Writing in the spirit of the great [Frédéric Bastiat](#), who parodied government intervention with devastating effect,³³ Rockwell invites us to imagine that the Fed, colluding with commercial lenders, creates an apple boom that drives the price of apples from \$3 per kilo to \$10. Anticipating that the price will continue to rise, businesses and individuals buy apples, borrow to buy them and even use them as collateral for loans.

Now assume that the price falls to \$7 per kilo. Not a single sparrow can fall without the government's approval, and so this decrease of price becomes a "problem." How can the government "manage" it? Let's say that it attempts to boost the price by forcing supermarkets to sell them at \$10 per kilo. But consumers won't pay \$10, so the apples rot on the shelves. *The government says the bust (i.e., the glut of apples and the consequent downward pressure upon their price) and not its cause (namely the policies that artificially boosted the price in the first place) is the problem.* Having misdiagnosed the problem, the government proceeds to mull misguided "solutions." Should it assist people who borrowed to buy apples? Should it buy the apples of people who borrowed against them and are now "under water"? Should it guarantee the loans of banks who lent on the security of apples? Partly nationalise the apple and lending industries? After trying these measures and watching them fail, the government decides to "show decisive leadership." In order to "protect" apple owners and "support" lending to buy apples, the government decrees that it will buy all apples (at \$10 per kilo) and all supermarkets (at a price which it will determine) and then force "its" supermarkets to buy all of "its" apples!

The trouble is that one intervention always leads to another, even more absurd and eventually draconian intervention. The government can imprison anybody who doesn't want to pay \$10 for a kilo of apples. But this extreme doesn't alter its "problem" one iota: if left alone, buyers and sellers will exchange apples at significantly less than \$10 per kilo. The government's actions may well obscure, but cannot alter, this essential fact. Any attempt to change it is like trying to repeal the law of gravity. Of course, the central bank can inflate wildly and raise all consumer prices to the point that apples nominally cost \$10 per kilo. But this is purely cosmetic: in real terms, the price hasn't budged. Whether it's apples or houses or any other good or service, government's real problem is that it's unwilling to tolerate free trade among consenting adults, and its myriad and

³³ Among Bastiat's better-known works is *Economic Sophisms*. It contains many strongly-worded attacks on statist policies, including the famous satirical parable known as the "[Candlemakers' Petition](#)." Bastiat described a demand from the candlemakers' guild to the French government. In order to prevent "unfair competition" with their products, the guild insisted that the government to block the sun. Much like Jonathan Swift's *A Modest Proposal* or Benjamin Franklin's anti-slavery tracts, Bastiat used humour and rigorous logic pushed to its consequences to highlight the absurdity of government interventionism. Bastiat [taught us](#), and the [Bailout of Abominations](#) forcefully reminds us, that "government is the great fiction through which everybody endeavours to live at the expense of everybody else."

increasingly crazed attempts to countermand free-market exchanges are pointless and destructive (see also Rockwell's [Bush the Socialist and Destroyer](#), Frank Shostak's [The Rescue Package Will Delay Recovery](#) and [The Bailout Reader](#)).

Misconceptions About Inflation and Interest Rates Beget Damaging Monetary Policy

“The Reserve Bank has signalled it will do whatever it takes,” the front page of *The Australian* (8 October) trumpeted, “to keep the Australian economy from sliding into a global recession, delivering a massive one percentage point cut in [its Overnight Cash Rate.]” Its reporters applauded its stance. One said “it’s the RBA interest rate rescue package that hopes to save Australia from a credit crunch recession,” and added “it has raised hopes around the world that other central banks also will soon cut rates to try to revive the global economy.” *The Australian* editorialised: “the RBA has been proactive in defending our real economy ... the biggest cut [of the OCR] since 1992 was warranted by the recent deterioration in prospects for global growth” and it will “boosts consumer spending, saving and investment and increase business and consumer confidence, essential for maintaining employment.”

Considered as a whole, these contentions take it for granted that a central bank’s policies can tame the business cycle. If so, then why are so many countries presently on the verge of recession or even depression? A rising CPI, as students of the Austrian School well know, is an *eventual consequence of* inflation, but it is *not the same thing as* inflation. What is inflation? It is an expansion of the supply of money. In a fiat monetary system, only central banks can inflate the supply of money; and during 2007, inflation in Australia approached 20%. Hence central banks do not *fight* inflation: they *create* it. Only they – and nobody else – can do so.

Inflation is an inevitable consequence of interventionist government. By creating inflation, which corrupts interest rates by suppressing below the level that would prevail in a free market, central banks encourage consumers and investors to borrow. Alas, artificially-low rates beget unaffordable spending sprees and poor investments. Central banks and governments unleash a damaging cycle of boom and bust. Hence they do not *tame* the business cycle; they *worsen* it. It is not the allegedly “high” rates of 2005-2007 that have caused the trouble: it is the artificially low rates (if they weren’t so, then why has borrowing grown so much more quickly than output?) of the past 15 years that have accumulated trouble. Poindexter (who, according to *The Australian*, welcomed the OCR’s cut and opined that it would help to maintain financial stability) is therefore diametrically wrong: the government’s frenzied attempts to create “stability” actually foment chaos.³⁴

³⁴ *Plus ça change, plus c’est la même chose.* “Looking back,” said D.H. Robertson in “How Do We Want Gold to Behave?” (*The International Gold Problem*, Humphrey Milford, 1932), “the great American ‘stabilisation’ of 1922-1929 was really a vast attempt to destabilise the value of money in terms of human effort by means of a colossal programme of investment ... which succeeded for a surprisingly long period, but which no human ingenuity could have managed to direct indefinitely on sound and balanced lines.”

The Australian's front page continued: “home buyers and businesses will get immediate relief, with the five major banks announcing [cuts averaging 0.8 percentage points] to their standard mortgage rates yesterday and other banks expected to follow suit over coming days. And the banks will also receive assistance from the RBA’s surprise move, which is expected to reduce their funding pressures and make it easier for them to lift lending to households and [businesses].” Therein lie further biases and misunderstandings. Australian banks rely upon retail deposits to finance ca. 50% of their lending, and upon wholesale markets to finance the remainder. Retail deposits are an overwhelmingly domestic source of funds, and wholesale markets are a disproportionately foreign source. The RBA cannot control, or even influence, the cost of funds sourced from overseas – which during the past year has risen drastically. The banks’ increasing demand for deposits, caused by the rising cost of foreign funds, has placed upward pressure upon deposit rates. Through its OCR, however, the RBA can influence the cost of domestic deposits. The reduction of the OCR places downward pressure upon the cost of deposits – and thus, other things equal, the cost of funds.

The conclusion is as inescapable as it is unspoken: *the RBA’s policy of inflation assists Australia’s commercial banks and legions of debtors by punishing Australia’s embattled band of savers.* Moreover, the additional and hefty reductions of the OCR that market participants expect during the next 6-12 months will impose further punishment upon savers. Democracy, remember, is a means whereby two wolves and a lamb decide by majority vote what will appear on the dinner menu. By a wide majority, Australians are debtors rather than creditors. Democracy in Australia thus takes from the prudent and frugal, gives to the improvident and rescues the profligate from their follies.

But don’t excessive borrowing and lending, and the accumulation of bad debt and poor investments, lie at the heart of the crisis?³⁵ Are Australian consumers not

³⁵ Even The Frat Boy says so! In an astonishing outburst of honesty and coherence, George W. Bush stated in his [Address to the Nation](#) (24 September): “How did our economy reach this point? Well, most economists agree that the problems we are witnessing today developed over a long period of time. For more than a decade, a massive amount of money flowed into the United States from investors abroad, because our country is an attractive and secure place to do business. This large influx of money to U.S. banks and financial institutions – along with low interest rates – made it easier for Americans to get credit.

“Unfortunately, there were also some serious negative consequences, particularly in the housing market. Easy credit – combined with the faulty assumption that home values would continue to rise – led to excesses and bad decisions. Many mortgage lenders approved loans for borrowers without carefully examining their ability to pay. Many borrowers took out loans larger than they could afford, assuming that they could sell or refinance their homes at a higher price later on.

“Optimism about housing values also led to a boom in home construction. Eventually the number of new houses exceeded the number of people willing to buy them. And with supply exceeding demand, housing prices fell. And this created a problem: Borrowers with adjustable rate mortgages who had been planning to sell or refinance their homes at a higher price were stuck with homes worth less than expected – along with mortgage payments they could not afford. As a result, many mortgage holders began to default.

already among the most indebted in the Western world? The RBA's supremo told us only last month ([The Directors' Cut: Four Important Long-Run Themes](#), 17 September) that "this long period of gearing up by households might now be approaching an end. Certainly household credit growth is much slower at present than it has been for some years, running roughly in line with income growth. Might we see this conservative approach to debt among households persist? It is hard to know the answer to this question ... But there is also a good chance that households will for some time seek to contain and consolidate their debt, grow their consumption spending at a pace closer to income, and perhaps look to save more of their current income than in the recent past. It is possible that we are witnessing the early part of a new phase where the household spending and borrowing dynamic is different from the past decade and a half." Glenn Stevens has needed less than a month to replenish his punchbowl, rejoin the party and ply the drunks with even stiffer drinks.

Australians, like their counterparts in North America and Europe, have borrowed way too much and saved far too little. They now face the consequences of their recklessness: namely the necessity that they purge bad debts and "investments." The trouble is that the RBA, too, has learnt the wrong lesson about the Great Depression. Rather than step aside and allow the purge to occur, sharply but quickly, it is using every means at its disposal to keep the sordid old game going, i.e., is encouraging people to borrow and consume today rather than save and invest for tomorrow. Like the Fed and Bank of England, etc., it believes that it can and should countermand market signals – which point unequivocally towards *higher* interest rates. Higher rates will help to generate the savings that are required to repair the mistakes of the past. At a time when big fires are burning on adjoining properties, lower rates accelerate the accumulation of detritus on an already tinder-dry forest floor.

Politicians and bureaucrats think that a stroke of a minister's pen or an Act of Parliament trumps the natural laws of economics. They are sadly mistaken. The RBA's abject capitulation to the clamour to "reduce interest rates" will NOT help matters: quite the contrary, it will temporarily reward debtors who have made poor investments, encourage them to make additional mistakes and also prompt more people to join the debt bacchanalia. The RBA's futile attempt to avert (or at least to delay) recession will therefore make the eventual recession worse than it would otherwise be.

"Regime Uncertainty" Then and Now

The damage that politicians inflict upon commerce and industry takes a very concrete form, namely the myriad interventionist policies they undertake. But their harm doesn't end there. More subtle but also very injurious is their threatening rhetoric, i.e., their statements about what's wrong with the world and who's caused it, what they would like to do if only they could, what should happen, etc. The effect of these words is to add another layer of uncertainty into entrepreneurs' plans.

The sounder the entrepreneur's plans and the better his forecasts, the higher will be his profits. If, on the other hand, he overestimates the demand for his goods or services, he will not fulfil his plans and may suffer losses. And if his losses are sufficiently severe, he will face bankruptcy, cease production and exit the market. The world of commerce and industry is innately uncertain. No entrepreneur can say for sure what the prices of his outputs (and hence revenues) will be in the future; nor can he say what the prices of his inputs (and hence costs) will be. Hence he simply cannot know in advance whether his plans will generate profits or losses. He gathers information, analyses it, draws conclusions and acts accordingly; but the investment of capital is ultimately an act of faith.

Politicians' threats to punish entrepreneurs, gaol them in ever tighter regulatory cells and suddenly and unexpectedly abolish old rules and introduce new ones adds to the uncertainty. The greater the uncertainty, the bigger the margin of safety the entrepreneur/investor requires before he will act; and if he decides that uncertainty is simply too great, then he will not invest. Politicians' rhetoric thus reduces investors' confidence; and if the rhetoric sufficiently strident, it can induce them to withhold their services. More generally, at the heart of every commercial transaction is an exchange of property. Without clear rules regarding the ownership and exchange of property and confidence that these rules will be respected in the future, the price system and free enterprise cannot function. To threaten or weaken private property rights is, unwittingly or otherwise, to dampen productive and long-term economic activity such as private investment.

The presidency of Franklin Roosevelt introduced the rhetoric of overt class warfare into American politics. His acceptance speech for the Democratic presidential nomination in 1936 was widely regarded as a declaration of war against free enterprise. He charged that "economic royalists" were attempting to regain the power they had allegedly possessed before the Depression, and that during his first term they had taken every opportunity to block and negate his policies. FDR attacked "big business" and "organised money," and claimed that they had caused the misery and misfortune that the general public had suffered. Roosevelt's campaign of 1936 polarised and frightened the public. As a result, the Democrats' standard bearers for president in 1924 and 1928, John W. Davis and Al Smith, publicly deserted FDR and supported his Republican challenger. So too did Roosevelt's first director of the budget.

These actions had very unfortunate economic consequences. According to Gene Smiley, the author of *Rethinking the Great Depression: A New View of Its Causes and Consequences* (Ivan Dee, 2002),

a primary explanation for [America's] slow recovery [from the Depression] can be found in the concept of "regime uncertainty." Especially from 1935 on, the New Deal ravaged the confidence of businessmen. As they became less and less certain that private property rights in their capital and its income stream would be protected and maintained – in other words, uncertain about the continuation of the current "regime" of private property rights – they became less and less willing to make investments, especially longer-term

investments in structures and long-lived machinery. Increasingly, only short-term investments with quick payoffs were viewed as desirable. Threats to private property rights may come from many sources, including tax increases, new taxes, confiscation of private property, and business regulation that reduces an owner's rights over property.

The New Deal's central planners made it quite clear that they sought to create a planned economy in which the government's plan would crush individuals' plans. Smiley therefore concludes: "the recovery from mid-1935 to mid-1937 and again after the 1937-1938 'depression within a depression' was slow because business was reluctant to invest, expand and undertake potentially risky innovations. They were increasingly uncertain of the rules they were operating under and how secure their property rights were. In the 1930s the Roosevelt administration abruptly and dramatically altered the institutional framework within which private business decisions were made – not just once but several times. The effect was to retard the recovery from the Great Depression of 1929-1933."

What have today's crop of American politicians learnt from history? Not a damn thing. Investigate short sellers, urges New York's attorney-general. "They are like looters after a hurricane," [said Andrew Cuomo](#). Hold hearings that will grill Wall Streeters, [demanded Nancy Pelosi](#). "Democrats believe in the free market, which can and does create jobs, wealth, and capital, but left to its own devices it has created chaos. Let us be clear: This is a crisis caused on Wall Street ... Over the course of the next few weeks, we will continue to hold investigative and oversight hearings to find out how the crisis developed, where mistakes were made, and how the recovery must be managed. "Fire the whole trickle-down, on-your-own, look-the-other-way crowd," [proposed Barack Obama](#), and "get rid of this whole do-nothing approach to our economic problems."

And then there's Poindexter. In a [speech delivered on 3 October](#), he deplored "a fundamental failure of values" and attacked "the political and economic ideology of extreme capitalism embodied by [Gordon Gekko](#)" and "the culture of greed" as causes of our troubles. "It is perhaps time now to admit that we did not learn the full lessons of the greed-is-good ideology. And today we are still cleaning up the mess of the 21st century children of Gordon Gekko." And just in case he didn't make himself clear: "this crisis bears the fingerprints of the extreme free-market ideologues who influence much of the neo-liberal economic elite, free-market ideologues who have a naïve belief that unrestrained markets are always self-correcting and that markets left to themselves will always achieve optimum outcomes ... Ideologues who believe that government is always the problem, never the solution." Poindexter sought to assure Aussies that he stood with the non-ideological and fair-minded angels and against the doctrinaire free market devils. "This is very much a values debate: Gordon Gekko, greed and immediate gratification as against a culture that values a fair go, that values hard work and that values thinking about and preparing for tomorrow."

Poindexter and countless other politicians, journalists and commentators, here and overseas, are urging, yet again, that their subjects accept a monumental lie –

namely that free trade between consenting adults and secure rights to private property are wrong and damaging. *They are desperate to hide a vital truth: buying and selling in a free market encourages virtue and suppresses vice.*³⁶ A laughable but nonetheless sinister undertone accompanies many of these politicians' strident and sometimes hysterical rhetoric: "submit to my demands or else there will be another Great Depression." But the Crash of 1929 and the Great Depression were different things, and the former did not cause the latter. What made the depression of the 1930s "great" was not magnitude but its duration. Not only interventionist policies, but also the New Dealer's menacing rhetoric, did nothing to speed recovery and much to impede it.

"Shorting" provides a good example. Not long after the Crash of 1929, Herbert Hoover denounced short sellers. Like today's crop of polities, he demanded that their activities be curbed if not banned. And like some of today's polities, such as John McCain, he blamed the crash upon "bear raids" or "bear parties" and "certain gentlemen" who indulged these practices. Then as now, experts (and non-experts) described in great detail the difference between "normal" (or "covered") short sales and "naked" ones; and then as now, various curbs and bans momentarily cheered market participants. All to no avail.³⁷

Franklin Roosevelt intensified Hoover's anti-capitalist fusillade, and used the falling stock market as an excuse to trash markets generally. New Dealers even used the same mocking phrases that Obama does today. The rich might think that wealth trickled down, Roosevelt's speechwriter Sam Rosenman sneered, but "Roosevelt believed that prosperity did not 'trickle' that way."

In 1933, Roosevelt chose the victim for his primary show trial and launched his major *ad hominem* attack. Andrew Mellon was a prominent banker, an industrialist and Secretary of the Treasury from 1921 until 1932. He is the only Secretary of the Treasury who served under three Presidents (Harding, Coolidge and Hoover). He was one of the most respected businessmen of his day; as such, he was an irresistible target of the New Dealers. Upon entering office, and with the full backing of Warren Harding,³⁸ he slashed taxes and reduced the federal debt that had exploded during the First World War.

At the onset of the Depression, Mellon (along with Hoover and other leading members of his administration) became very unpopular. Milton Friedman and Ben Bernanke, as well as many other leading mainstream economists, attribute the

³⁶ See, for example, H.B. Acton, *The Morals of Markets and Related Essays*, Liberty Fund, 1993) and James Otteson, *Adam Smith's Marketplace of Life* (Cambridge University Press, 2002).

³⁷ A good collection of articles summarising short-selling, and the stupidity of curbing and banning it, appears in the "Short Selling" section of the Ludwig von Mises Institute's [Bailout Reader](#). See also LewRockwell.com's [Recession Reader](#).

³⁸ America has not had a great president (that is, a stalwart defender of the Constitution) since Grover Cleveland; and it has not had a tolerable one (i.e., one who grudgingly respected it) since Warren Harding and Calvin Coolidge. See also [Missing Warren G. Harding](#) by Lew Rockwell.

collapse of the American banking industry partly to the popularity among the Federal Reserve's leadership of Mellon's infamous "liquidationist" thesis – namely that the bankruptcy of weak banks was a harsh but necessary prerequisite to the recovery of the banking system. Mellon advocated (but was unable to prevail upon Hoover to order) reductions of expenditure that would maintain the federal budget in balance, and he opposed the relief by the state of suffering. (As a major and prominent philanthropist, Mellon stoutly advocated the private provision of charity.) Mellon spent most of 1929-31 overseas, negotiating the repayment of European war debts from the First World War. In February 1932, he left the Treasury Department and became Ambassador to the UK. He remained in Britain one year and then, when FDR became president, retired to private life.

At that point Evil Franklin pounced. In 1933, Mellon's successor as Treasury Secretary, Henry Morgenthau, instructed a subordinate, Robert Jackson, to prosecute Mellon for tax evasion. Jackson hesitated, but Morgenthau insisted. "You can't be too tough in this trial to suit me." Jackson then exclaimed "Thank God I have that kind of boss!" Examining the skimpy evidence, a grand jury declined to indict Mellon. Undeterred, the government then began multiple actions, all of them as spurious as they were vindictive. Mellon's exoneration came – but only after he died. Meanwhile, Roosevelt rewarded his attack dog, Jackson, with a seat on the Supreme Court.

In those years, Wall Street and Main Street were trying to recover, but politicians, prosecutors and tax collectors were determined to block the way. The signal Washington emitted in these years was loud and clear: "We Hate Capitalism, Free Markets, Businessmen and Entrepreneurship." When Mellon died in August 1937, investors and creditors found themselves utterly alone and in hostile and uncharted waters. Negatives such as rising labor costs and tightening regulations that previously seemed difficult were now deemed insurmountable. Reflecting the black mood, the Dow dropped from 189 on the day that Mellon died to 120 – which was well below the lowest ebb of 1929 – in February 1938.

In November 1937, in the midst of the Depression-Within-the-Depression, a desperate Henry Morgenthau traveled to New York in order to placate a crowd of 1,000 economists and businessmen. Members of the audience bitterly laughed at his attempt – which Morgenthau knew was too little and too late. By 1938, the New Dealers quietly admitted to themselves that their rhetorical outbursts had failed to reverse the Depression. Quite the opposite: their disastrous policies, plus the rhetoric that promised even worse policies to come made matters worse. The New Dealers, in short, caused capital to go on strike. Implicitly accepting defeat, the New Dealers turned to the war in Asia and the impending war in Europe to revive their fortunes.³⁹ The point for us is clear. Anti-capitalistic sneers and the assault of one's opponents, however much politicians might enjoy these things, cannot bring recovery.

³⁹ See in particular Thomas Fleming, *The New Dealers' War: FDR and the War Within World War II* (Basic Books, 2001) and Richard Stinnett, *Day of Deceit: The Truth About FDR and Pearl Harbor* (The Free Press, 2001).

It's a Crisis of the Welfare State of Credit – NOT of the Free Market

The 20th century was the century of the welfare state of credit. In the U.S., for example, Congress created the Federal Reserve System (in 1913) in order to prevent any repeat of the Panic of 1907, and in the 1930s it enacted a raft of legislation in order to combat and prevent any repeat of the Great Depression. The Glass-Steagall Act of 1933 established the Federal Deposit Insurance Corp. and various changes to the banking industry. It banned certain practices whose presence had allegedly caused (and introduced other practices whose absence had supposedly deepened or lengthened, and yet others whose presence they supposed would prevent the return of) the Depression. At Bretton Woods, New Hampshire in 1944, a series of agreements imposed the welfare state of credit upon a shattered world. Bretton Woods established a new monetary regime and associated regulations for international monetary management, rules for financial and trading relations among the world's major industrial nations, and organisations (most notably the International Monetary Fund). Subsequent amendments such as the Smithsonian Agreement of 1971 ended the system of fixed exchange rates. Some economists have referred to the system which evolved after 2001 (in which currencies, particularly China's, remained fixed to the \$US) as Bretton Woods II. The unstated purpose of Bretton Woods I and II is to banish any return of the gold standard into national and international usage.

The welfare state of credit is thus a global structure of Elites Who Know Best. Its purpose is to achieve financial and economic stability – that is, to avoid bank runs, panics in stock and bond and other financial markets, and economic depressions. The objective, in other words, is to anticipate, mitigate and prevent the downward leg of the business cycle. At all costs, its goal is to prevent any recurrence of the Panic of 1907 and Great Depression. As its name suggests, the welfare state of credit is the financial counterpart of the more familiar welfare state of income and labour (whose objectives, respectively, are to prevent any repeat of the material hardship and unemployment that characterised the 1930s). Just as the welfare states of income and labour have perverse effects (namely of feeding the very diseases they are supposedly trying to cure), the welfare state of credit spawns speculative frenzies and encourages excessive risk-taking in stock, bond and other financial markets – whilst simultaneously attempting to prevent the losses associated with excessive risk-taking. The welfare state of credit exacerbates the boom that causes the bust; at the same time, it attempts to abolish the bust. It thereby promotes risky behaviour and even recklessness, and subsidises failure.

In one obvious respect, this welfare state has failed. The cycle of boom and bust has clearly not disappeared: since the Second World War, it has often appeared at some junctures and in specific sectors, and at other times in whole industries. It's true that it hasn't simultaneously appeared in extreme ways across all sectors. The system is designed to prevent such a thing. In that respect, says the establishment, the welfare state of credit has been a resounding success. Slumps occasionally pockmarked the second half of the 20th century. You may call these interludes what you will, says the mainstream; but because they do not remotely compare to

the 1930s you cannot call them depressions. The powers that be add that decades have elapsed since Australasian, North American and Western European financial markets last endured a really bracing bear market.

In both economic and financial terms, the mainstream contends that the stability – namely the absence of another Great Depression – of economy and finance since the Second World War provides compelling evidence of the success of the welfare state of credit. Students of the Austrian School counter that stability is not evidence of *success*: it is evidence of *artificiality*. For seven decades, Soviet Communism was also “stable.” But its sudden and unexpected collapse in the early 1990s demonstrated – just as Ludwig von Mises foresaw in [Economic Calculation in the Socialist Commonwealth](#) (1920) and in [Socialism: An Economic and Sociological Analysis](#) (1922) – that it had always been unworkable.

Central planning in the traditional Marxist sense has been completely discredited. Yet most people still believe – fervently – in central planning as it is practiced by the key institutions of the welfare state of credit. Politicians, bureaucrats and their lackeys in the media, universities and major investment houses believe that central bankers’ manipulation of *one* interest rate (the Overnight Cash Rate, Federal Funds Rate, etc.) can steer the ship through rough financial and economic shoals. More generally, the agents of the state encourage their subjects to believe (or at least to accept) that the central bank is all-powerful. That they routinely bequeath to us the wrong OCR is not the point. No single person, or small group of people, can possibly know what the right rate should be.

The point – and the Achilles Heel of central banking – is that central bankers assiduously impart the impression that they know. Perhaps the subjects of the welfare-warfare state need to believe that somebody is in charge. The idea that no man is in command reassures rather than disturbs the student of the Austrian School, but may not embolden the average buyer of bank stocks, BHP-Billiton or a managed fund. Debtors want to believe that Ben Bernanke and Glenn Stevens not only know what the right short-term rate is (invariably, they also hope that the right rate is lower than the current rate), but also that they will unerringly give it to us. Believing this, people’s calculation of risk and reward becomes distorted. Hence they take risks they wouldn’t otherwise take. They believe, incorrectly, that all’s well because the central bank will not allow unpleasant things to occur.

In reply, Bernanke and Stevens would say something like “that’s not true: I’ve often warned about cycles.” But they haven’t in any meaningful way. Neither has ever mouthed the supreme insight of the Austrian School’s theory of the business cycle – namely that artificial booms, aided and abetted by central banks, cause real busts. No central banker has ever confessed to others in public, and perhaps not even to himself in private, that when he subsidises the creation of credit and thereby helps to suppress rates of interest below levels that would prevail in free markets, he causes markets to send false signals and encourages investors to undertake poor investments.

In their own defence, Bernanke and Stevens would also say “I’ve often warned about the danger of inflation.” But that’s standard central-banking boilerplate. Central bankers deplore one consequence of inflation. But among the contributions of the Austrian School is the insight that the rising prices of financial assets and of consumer goods are possible consequences of a single cause: the inflation of the supply of money. The insidious consequences of inflation, in other words, can appear on the stock exchange as well as in the aisles of the supermarket. In Wall Street and the financial press, inflation means simply a rising CPI. But to students of the Austrian School, that hardly scratches the surface.

Like Soviet central planners of yesteryear, so too today’s monetary central planners: they are attempting to achieve the impossible. What we are presently witnessing is wholesome and necessary – and as loathsome to the establishment as cod liver oil is to a young boy. Monetary (and, for that matter, fiscal) central planners are indeed “the best and the brightest.” The trouble is that people have forgotten that this phrase became prominent as the title of a book written by David Halberstam in 1972. Halberstam, a Pulitzer Prize-winning journalist, showed that the men who planned and promoted military aggression and mass murder in Vietnam were among the most intelligent, well-connected and self-confident people in America. Not *despite* this, but *because* of it, “the best and the brightest” blindly and arrogantly led their compatriots into a bloody and disastrous defeat.

Halberstam showed that any old Tom, Dick and Harry can err; but to create a real catastrophe, one that kills and otherwise afflicts millions, you must boast a degree from an Ivy League university. George W. Bush, by the way, is the only U.S. President who has degrees from both Harvard (MBA) and Yale (undergraduate in history). Further, Fed Chairman Ben Bernanke’s undergraduate degree is from Harvard, and before his ascension to the Fed he was the head of the Department of Economics at Princeton. Henry Paulson has an MBA from Harvard. The failing of the best and the brightest is that they think – contrary to the teachings of the Austrian School’s masters – that there exists some set of data or some statistical model that enables them to see the future and to take corrective action before it becomes the present. Alas, not only are they unable to see the future: they have misread the past.

Stand Fast, Craigellachie!

The world does indeed face a crisis. It’s a crisis of ideas, and it takes the form of the utter bankruptcy of mainstream economics and finance, and of its conception of money, credit, interest, banking and the business cycle. Above all, the crisis has exposed the utter falsehood of the proposition that Government Knows Best. The state is an idol: it is not our salvation. Politicians babble incessantly about “leadership,” sometimes in Churchillian terms, but they can offer only fallacy, dissimulation, brazen lies and outright failure.

It’s in a crisis, when emotion threatens to overwhelm reason and the pressure to

conform becomes intense, that we can distinguish people who stick to their principles from those who never really believed them in the first place. Examples include the days after 11 September 2001, and also the months before and after the outbreak of Anglo-American aggression against Iraq in 2003. On both occasions, erstwhile sceptics of intervention abandoned the [Axiom of Non-Aggression](#) and embraced the new ideal of eternal war for perpetual imperialism. [Paleolibertarians](#) associated with the Austrian School, particularly Misesians and Rothbardians at the [Ludwig von Mises Institute](#) and [Le Québécois Libre](#), on the other hand, stood virtually alone and maintained a consistently (that is, non-interventionist both at home and abroad) *anti-étatiste* position.

And what do we see? People who had hitherto mouthed their support of the free market, small government, etc., suddenly become advocates of the Leviathan state and unlimited interventionism – including the nationalisation of banks! Their words and deeds recall the Communists of the late-1930s and early-1940s. Before the [Molotov Ribbentrop Pact](#) of 24 August 1939, Commies purported to loath National Socialism. But under the terms of the Pact, the evil dictators agreed to make nice. A handful of Communists in Western Europe and North America were outraged that Stalin would ally with Hitler. But the vast majority robotically followed Stalin. The Pact remained in effect until National Socialist Germany invaded the Soviet Union on 22 June 1941. Overnight, Communists, fellow-travelers and their useful idiots in Britain and North America launched frenzied demands for an “International Anti-Fascist Front.”

Editorialists at *Der Murdochischer Beobachter* (also known as *The Australian*) exhibit a similar contempt for logical and moral consistency. On 9 September they told us that “capitalism has served Australia well,” that “global capitalism [has been] responsible for a greater reduction in world poverty in the past 50 years than was achieved in the previous 500 years,” and that “the new prophets of doom ... are akin to the ‘End is Nigh’ socialists of the 1970s.” So far, so good. But they also discerned a snake in paradise: “Capitalism retains the ability to repair its flaws and nurture the human spirit better than any alternative.” What are these flaws? The editorialists do not deign to inform us: they merely assert and insinuate rather than reason validly towards a conclusion.

The editorialists’ myriad other assertions contradict their allegedly pro-capitalist stance. In actual fact, they reckon that *governments* possess the ability to repair capitalism’s alleged flaws. How else can we make sense of their editorials? On 11-12 October alone, for example, they

- approvingly quoted the evil Franklin Roosevelt;
- asserted (despite “the failure of multi-billion dollar interventions by central banks and governments to calm the markets”) that “a co-ordinated approach [by the G20] is the only way forward;”
- grovelled to Poindexter: “recent turmoil proves that there are no guarantees of success in plunging markets devoid of investor confidence. But such a comprehensive and unified approach, on

behalf of 90 per cent of the world's economy and two-thirds of its population, offers substantial hope. Mr Rudd is right when he says the G20 is the best forum to organise a medium-term and long-term regulatory response to the global crisis.”

- avoided an obvious question staring them and their fellow welfare-statists-of-credit in the face: if the interventions undertaken thus far have (as they rightly acknowledge) failed, on what basis can one believe that broader and deeper intervention won't also fail?
- ran under Karl Marx's skirt. In particular, they assert “in essence, what is required is quite simple. The central banks around the world need to adopt a united front to take over the counter-party risks of the trading banks. This decisive measure will restore confidence to world financial markets and trust among the trading banks, ensuring global credit can flow freely. This is what the G20 leaders must have the political will to accomplish.”

During the boom, fair-weather free marketers fitfully opposed a few minor interventions here and there – but enthusiastically championed the welfare state of credit, central banks and their policy of high inflation. And now, during the bust which is the inevitable consequence of the very monetary arrangements and policies they long espoused, they have quickly folded their colours, squealed like piglets and defected *en masse* into the ranks of their erstwhile opponents. How can this be? More generally, how can they offer half-hearted criticism of the state's intervention in some areas, but when it comes to money, banking and credit enthusiastically climb aboard the Marxist bandwagon? (The fact that they don't know that they're doing so simply magnifies their stupidity.)

Friedmanites, supply-siders, Chicago Schoolies, public choicers and Keynesians comprise a single – statist – lump. None possesses a lucid theory of capital, interest and the business cycle; all have succumbed to the temptation of political influence; and they know or care nothing about the Austrian School. Hence mainstream economists and finance journalists simply cannot offer a coherent analysis of the financial distemper of our times. They oppose neither the existence nor the terrifying power of central banks – which are the equivalent of Soviet-style central-planners applied to the monetary realm. The virtual-unanimity within the mainstream about the state's monopolisation of money and credit explains why the nationalisation of the American, British and other banking systems is barely raising a mainstream eyebrow. If, deep down, your faith rests ultimately in central planning practised by central bankers, then the monopolisation of credit and the nationalisation of banking is the achievement of your fondest wish. Hence these fair-weather free marketers threaten rather than advance the cause of liberty. Their rhetoric is mere camouflage that obscures their socialism – which is not the humble collectivism of the disadvantaged, but rather the arrogant assertion of the right of the privileged minority to plunder everybody else.

Only the Austrian School offers a coherent analysis of monetary cause and effect. As in the 1920s, so in the decade from the mid-1990s: it discerned storm clouds

on the horizon, and now offers an alternative to the mainstream policies that will worsen rather than improve matters. Today's crisis, in effect, places you at a fork in the road. You must choose which path you will follow. On the one hand are the Austrians, and on the other the Marxists. "The key to the intricate and massive system of thought created by Karl Marx," wrote the great Murray Rothbard,⁴⁰ "is at bottom a simple one: Marx was a Communist." Similarly, the key to the Friedmanite, supply-side, public choice and Keynesian approach to money and credit appears at Agenda Item #5 of the Communist Manifesto. To endorse the creation of credit not backed by savings under the aegis of a central bank, the welfare state of credit, the artificial boom and the futile attempt to abolish the bust, the bailouts, nationalisations and all the rest – to support these things is to profess the "centralisation of credit in the banks of the state, by means of a national bank with state capital and an exclusive monopoly." Today's financial storm has cleared the air. You now see that you stand at a fork in the road, and that you must choose your path. Are you a staunch Austrian or a closet Marxist?

An Addendum: O Canada, the True North Strong and Free!

Perhaps because it's something that few Americans or Canadians will like, the mainstream media of both countries have largely ignored it. It will irritate Americans because, well before the Bailout of Abominations, they falsely imagined that they inhabit a free country. The outspoken Dutch-born economist Willem Buiter, a former member of the monetary policy committee of the Bank of England and now a professor at the London School of Economics, expressed this point well. In a commentary headlined [Time for Comrade Paulson to Pull the Plug on the Fannie and Freddie Charade](#), Buiter wrote: "There are many forms of socialism. The version practiced in the U.S. is the most deceitful one I know." If America has long been a much more socialist country than Americans will admit, then Canada is a somewhat less socialist one than many Canadians ardently want to believe. Commerce and capitalism created Canada; yet today's Canadians indignantly reject this vital truth (see also [Letter 65](#)).

The establishments on both sides of the border thus downplayed the release, on 16 September, of the [Economic Freedom of the World 2008 Annual Report](#). Conducted by the Fraser Institute in collaboration with various other think tanks, it shows that, for the first time, Canada (position #7) has overtaken the United States (tied at #8 with Australia). In this year's index, Hong Kong retains the highest rating for economic freedom (8.94 out of 10). The other top scorers are: Singapore (8.57), New Zealand (8.28), Switzerland (8.20), the United Kingdom (8.07) and Chile (8.06). The rankings (and scores) of other large economies are Germany, 17 (7.64); Japan, 27 (7.48); South Korea, 29 (7.42); France, 45; India, 77 (6.59); China, 93 (6.29); and Russia, 101 (6.12). Last year, Canada and America were nose-to-nose; this year, albeit by the slimmest of margins, Canada has pipped the U.S. And this year's classification predates the Bailout of Abominations, part-nationalisation of the banking sector and who-knows-what other desperate moves

⁴⁰ [Karl Marx: Communist as Religious Eschatologist](#), *Review of Austrian Economics*, 4, 1990: 123-179.

the Marxists-Within-the-Beltway (and at Westminster) will foist upon the public. Clearly, America and Britain are rapidly becoming even less free.

Compared with the interventionist upheavals south of the border and in the Old Country, Canada is a bastion of classical liberalism. If economic conditions in The True North Strong and Free are not as fraught as they are in the U.S. of Socialist A., it is because the Government of Canada has intervened less than Uncle Sam:

- the Bank of Canada's policy of inflation, whilst certainly damaging, has been less crazed than the Fed's;
- although its very existence is appalling, CMHC is a much less important securitiser of mortgages than Fannie and Freddie;
- Canadian banks are better-capitalised than American banks (indeed, next to Switzerland's they are the best-capitalised in the Western world, which means that they're among the least worst of a sorry lot);
- Canada's national debt, whose level (ca. \$C600-700 billion) is inexcusable, is much lower on a per capita basis than that of the U.S. – and is trending downwards;
- as of mid-October, a nationalisation of the Canadian banking sector does not seem to be imminent.

Of course, all this could change quickly. For decades, Canada's politicians have aped America's. That is, they have tended to adopt the interventionist fads wafting north across the border (see in particular Martin Masses's outstanding article [The Socialist Wind from the South](#)). And over the past several days the rhetoric of party leaders has shown disturbing signs that the habit of mimicry is hard to break. Yet events since early September have also given Canadians even stronger grounds – as if they lacked them previously! – to loathe *le socialisme à l'Américain*. If Canadians can accept the truth about their history, then in the years to come the situation that prevailed from the beginning of the 20th century (if not earlier) until the 1960s – namely that Canada was a more liberal (in the proper, classical sense of the term) nation than its southern neighbour – might again triumph.

In 1943, Bruce Hutchison, one of Canada's most perceptive observers, wrote “we Canadians can probably claim the distinction of being the most rugged surviving individualists ... The best Liberals, in their hearts, still believe in free trade, the play of natural economic forces, the sanctity of enterprise and the evil of monopoly. They behold on all sides precisely the opposite ... but they hope that a better day will dawn, that the world will come to its senses, trade again, reduce government interference, abolish monopoly.” Canada's calamity of recent decades is that this ideal has motivated so few Canadian hearts. Its greatness is that it once inspired so many. Its best hope is that it will do so again.

Chris Leithner