

# The Free Market

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## Money Inflation and Price Inflation

by Murray N. Rothbard

In the last few months, the Reagan administration seems to have achieved the culmination of its “economic miracle” of the last several years: while the money supply has skyrocketed upward in double digits, the consumer price index has remained virtually flat. Money cheap and abundant, stock and bond markets booming, and yet prices remaining stable: what could be better than that? Has the President, by inducing Americans to feel good and stand tall, really managed to repeal economic law? Has soft soap been able to erase the need for “root-canal” economics?

In the first place, we have heard that song before. During every boom period, statesmen, economists, and financial writers manage to find reasons for proclaiming that now, *this time*, we are living in a new age where old-fashioned economic law has been nullified and cast into the dust bin of history. The 1920s is a particularly instructive decade, because then we had expanding money and credit, and a stock and bond market boom, while prices remained constant. As a result, all the experts as well as the politicians announced that we were living in a brand “new era,” in which new tools available to government had eliminated inflations and depressions.

What were these marvelous new tools? As Bernard M. Baruch explained in an optimistic interview in the spring of 1929, they were (a) expanded cooperation between government and business; and (b) the Federal Reserve Act, “which gave us coordinated control of our financial resources and . . . a unified banking system.” And, as a result, the country was brimming with “self-confidence.” But, also as a result of these tools, there came 1929 and the Great Depression. Unfortunately both of these mechanisms are with us today in aggravated form. And great self confidence, which persisted in the market and among the public into 1931, didn’t help one whit when the fundamental realities took over.

But the problem is not simply history. There are very good reasons why monetary inflation cannot bring endless prosperity. In the first place, *even if there were no price inflation*, monetary inflation is a bad proposition. For monetary inflation is counterfeiting, plain and simple. As in



*This previously unpublished photograph of Ludwig von Mises was recently donated to the Institute by Margit von Mises.*

counterfeiting, the creation of new money simply diverts resources from producers, who have gotten their money honestly, to the early recipients of the new money—to the

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### INSIDE

**New Austrian “M”  
Reports on Institute Programs**

## From the President

### New Austrian Money Supply Measurement

by Llewellyn H. Rockwell, Jr.

Anyone trying to follow the changing money supply, and the effect it has on the economy, is struck by the bewildering series of M's that the Federal Reserve uses to define—and obfuscate—the money supply. Worse, the Fed continually changes the definitions.

During a discussion of these questions last fall at a meeting of Ron Paul's Council for Monetary Reform in the Mises Institute's offices, I asked Professor Murray N. Rothbard if an "Austrian M" could be created, based on the Mises-Rothbard theory of money and credit.

He said yes, and with the help of Professor Joseph Salerno of Pace University, he constructed the theoretical base of the measurement. Congressman Paul then assigned the Congressional Research Service to do the necessary statistics (figures which he updates frequently for his *Ron Paul Investment Letter*), and the "Austrian M" was born.

Murray N. Rothbard's Austrian M reveals that during 1979, 1980, and 1981 the money supply actually shrank. That's why the recession of 1982-83 was so severe. But subsequent monetary inflation has been massive, even if it has not yet shown itself in generalized price increases.

A sound monetary policy has two components: a real gold standard and the abolition of central banking. As we work towards those objectives, the Austrian M will help us better understand the mischief created by the central bank.

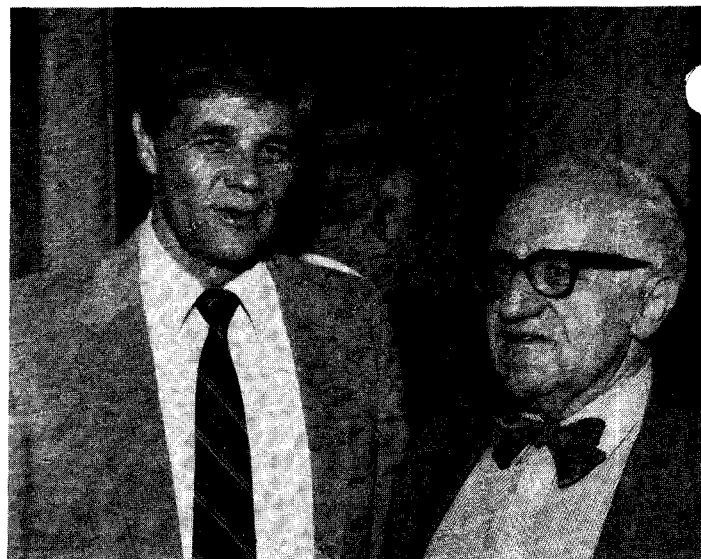
If you would like a complete technical and theoretical package on this important new development, send \$5 to Richard Hunting, Council for Monetary Reform, P.O. Box 1776, Lake Jackson, TX 77566. ■

### A Weekend With Murray N. Rothbard

In the first of what will be a regular series, Professor Murray N. Rothbard—the outstanding Austrian economist who serves as the Institute's vice president for academic affairs—taught a weekend seminar on August 1st-3rd in Washington, D.C.

Dr. Rothbard is writing a massive history of economic thought from the Austrian perspective—a work commissioned by Dr. Mark Skousen—and the seminar was based on the research for this new book.

Among the famous (and infamous) economists covered:



Institute Vice Chairman John V. Denson, Esq., and Professor Murray N. Rothbard.

A.R.J. Turgot, Adam Smith, Karl Marx, Carl Menger, Eugen von Böhm Bawerk, John Maynard Keynes, and—of course—Ludwig von Mises.

Attendance was to be limited to 25, but the demand from students and Members was so intense—with people traveling thousands of miles to attend—that the Institute's conference room was packed.

"Murray is famed for his ability to communicate his great scholarship with wit and eloquence," said Institute director Lew Rockwell. "It was a privilege for all of us to be there." Tapes are available. ■

### Major Academic Conference on the Federal Reserve

From the very beginning of our country, there were battles over central banking. Thomas Jefferson led the pro-gold standard, anti-central banking forces, and Alexander Hamilton championed easy money and an early version of the Fed. Thanks to President Andrew Jackson, central banking was uprooted. It took a major coalition of bankers, politicians, and intellectuals working for years to reimpose it through the Federal Reserve in 1913.

We can never have a sound monetary system, as Ludwig von Mises and Murray N. Rothbard have demonstrated, so long as we have the Federal Reserve and its recessions, depressions, and inflation. To build the intellectual foundation of the anti-Fed case, the Institute sponsored an historic academic conference on the Federal Reserve from September 4th-September 7th.

Featured were Senior Economist Joe Cobb of the Congressional Joint Economic Committee; Professor David

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counterfeiters, and to those on whom they spend their money.

Counterfeiting is a method of taxation and redistribution—from producers to counterfeiters and to those early in the chain when counterfeiters spend their money and the money gets respent. Even if prices do not increase, this does not alleviate the coercive shift in income and wealth that takes place. As a matter of fact, some economists have interpreted price inflation as a desperate method by which the public, suffering from monetary inflation, tries to recoup its command of economic resources by raising prices at least as fast, if not faster, than the government prints new money.

Secondly, if new money is created via bank loans to business, as much of it is, the money inevitably distorts the pattern of productive investments. The fundamental insight of the “Austrian,” or Misesian, theory of the business cycle is that monetary inflation via loans to business causes over-investment in capital goods, especially in such areas as construction, long-term investments, machine tools, and industrial commodities. On the other hand, there is a relative underinvestment in consumer goods industries. And since stock prices and real estate prices are titles to capital goods, there tends as well to be an excessive boom. It is not necessary for consumer prices to go up, and therefore to register as price inflation. And this is precisely what happened in the 1920s, fooling economists and financiers unfamiliar with Austrian analysis, and lulling them into the belief that no great crash or recession would be possible. The rest is history. So, the fact that prices have remained stable recently does not mean that we will not reap the whirlwind of recession and crash.

But why didn't prices rise in the 1920s? Because the enormous increase in productivity and the supply of goods offset the increase of money. This offset did not, however, prevent a crash from developing, even though it did avert price inflation. Our good fortune, unfortunately, is not due to increased productivity. Productivity growth has been minimal since the 1970s, and real income and the standard of living have barely increased since that time.

The offsets to price inflation in the 1980s have been very different. At first, during the Reagan administration, a severe depression developed in 1981 and continued into 1983, of course dragging down the price inflation rate. Recovery was slow at first, and in the last few years, three special factors have held down price inflation. An enormous balance of trade deficit of \$150 billion was eagerly financed by foreign investors in American dollars, which kept the dollar unprecedentedly high, and therefore import prices low, despite the huge deficit.

Secondly, and unusually, a flood of cash dollars stayed overseas, in hyperinflating countries of Asia and Latin America, to serve as underground money in place of the increasingly worthless domestic currency. And thirdly, the well-known collapse of the OPEC cartel at last brought down oil and petroleum product prices to free-market levels. But all of these offsets are obviously one-shot, and are rapidly coming to an end. In fact, the dollar has already declined in value, compared to foreign currencies, by about 30 percent since last September.

We are left with the fourth offset to price inflation, the increased willingness by the public to hold money rather than spend it, as the public has become convinced that the Reagan administration has discovered the secrets to an economic miracle in which prices will never rise again. But the public has not been *deeply* convinced of this, because real interest rates (interest rates in money terms minus the inflation rate) are at the highest level in its history. And interest rates are strongly affected by people's expectations of future price inflation; the higher the expectation, the higher the interest rate.

We may therefore expect a resumption of price inflation before long, and, as the public begins to wake up to the humbug nature of the “economic miracle,” we may expect that inflation to accelerate. ■

## An Introduction to Austrian Economics

The Mises Institute has received many requests from students and Members for a basic short course in Austrian economics. In response, Institute graduate students, under the direction of Professor Roger Garrison, taught such a program on the Auburn University campus from August 14-17.

The lectures covered the history of the Austrian school, and the Austrian perspective on economics as a coordination problem; competition and entrepreneurship; the economics of “market failures”; capital and interest; monetary theory and policy; and spending and taxes.

The texts were Stephen C. Littlechild's “The Fallacy of the Mixed Economy”; Ludwig von Mises' “Economic Policy”; Murray N. Rothbard's “The Essential Ludwig von Mises”; Thomas C. Taylor's “An Introduction to Austrian Economics”; and Lawrence H. White's “The Methodology of the Austrian School” (all available from the Institute).

Students and business people from 11 states attended. The faculty—in addition to Dr. Garrison—were Auburn graduate students John McCallie, Roger Koppl, Sven Thommesen, Mark Thornton, and Dipesh Shah. Tapes are available. ■

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Fand of Wayne State University; former Congressman Ron Paul of the *Ron Paul Investment Letter*; Professor Murray N. Rothbard of the University of Nevada, Las Vegas; Professor Joseph Salerno of Pace University; Professor Mark Skousen of Rollins College and *Forecasts and Strategies*; Professor Roger W. Garrison of Auburn; and Professor Richard Timberlake of the University of Georgia.

The conference was held at The Cloister, on Sea Island, Georgia, with visits to the former J.P. Morgan club on Jekyll Island where the Federal Reserve Act was drafted.

"The Institute's major conference on the gold standard has had a lasting effect for good," said Lew Rockwell. "I am convinced this historic meeting will do the same for the anti-central banking case." ■

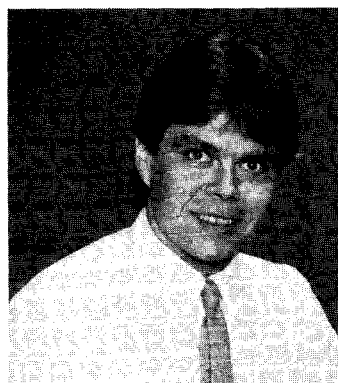
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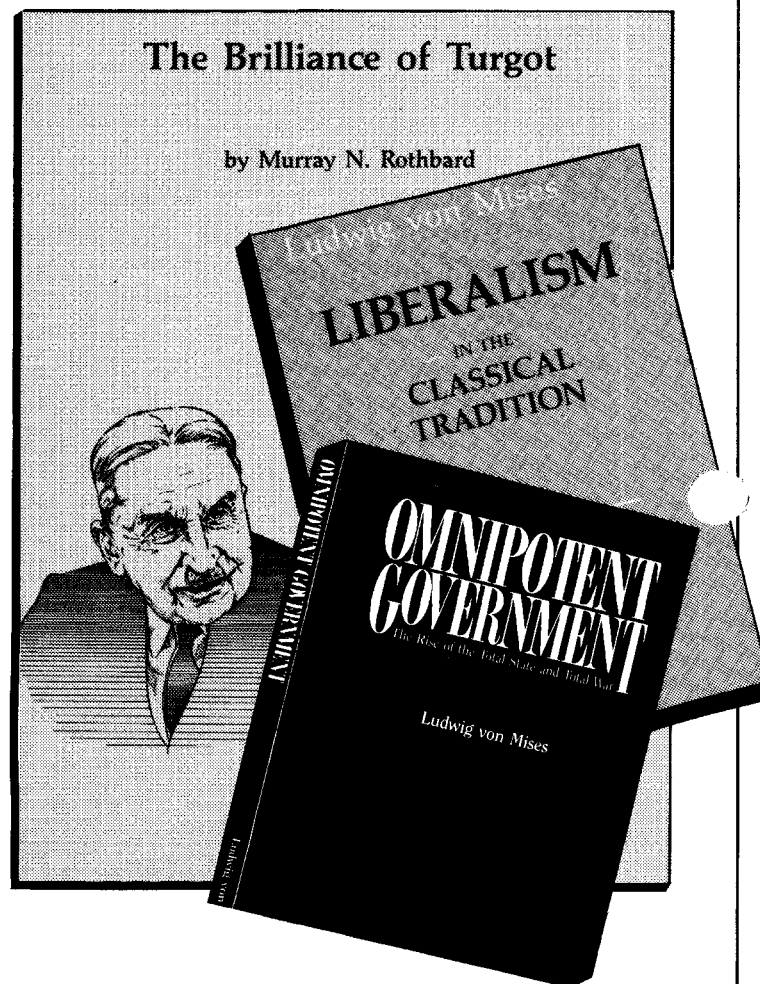
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The work of the Mises Institute has been helped significantly by thousands of dollars in matching gifts. We would be honored to have yours as well. ■



Don Boudreaux, the first Mises Fellow at Auburn University, recently became the first student to complete all requirements for the PhD in economics in Auburn's new program. Don—now assistant professor of economics at George Mason University in Fairfax, Virginia—wrote his dissertation under Professor Robert B. Ekelund, Jr.



## Special on Three Important Publications

Two important books by Ludwig von Mises—*Liberalism* and *Omnipotent Government*—have just been reprinted. The first lays out the freedom philosophy of classical liberalism, and the second discusses its enemy. And the Institute has just published Murray N. Rothbard's essay on A.R.J. Turgot, a neglected pioneer of Austrian economics and the free market. The retail prices, plus shipping, of these three works total \$25.40. This month's special for Institute Members offers an extraordinary 51% savings. If you want these publications for your own library, or as gifts, write "3" on the enclosed card and enclose your check for \$12.50, plus any tax-deductible contribution to the Institute's work.