

# THE FREE MARKET

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## The Fed: Reality Trumps Rhetoric

SHAWN RITENOUR

This article is adapted from the fifth chapter of *The Fed at One Hundred*, edited by Mises Institute Associated Scholar David Howden and Senior Fellow Joseph Salerno, published this year by Springer International.

### Federal Reserve Rhetoric

Throughout the existence of the Fed, its officers and intellectual supporters understandably asserted that the government's movement toward central banking was a most beneficial evolution. In a 1948 issue of *The Federal Reserve Bulletin*, for example, Fed Chairman Thomas B. McCabe asserted that money production could not manage itself, so we need a central bank such as the Fed that acts for the public interest. Nearly three decades later, the venerable Arthur Burns claimed that the basic assets of the Fed are concern for the general welfare, moral integrity, respect for tested knowledge, and independence of thought.

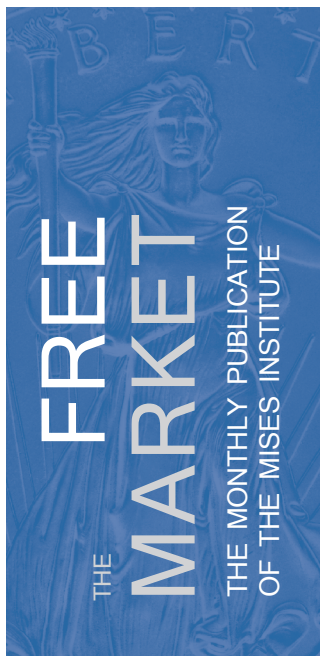
The alleged benefits from a Fed-managed elastic money stock became the standard justification for the Fed in later propaganda. Again in 1948, Fed Chairman McCabe asserted that a lack of a central bank caused a continual threat of financial panic, but the Fed put an end to this danger — a rather cheeky claim to make only a few years after the Great Depression. Subsequent Fed Chairman William McChesney Martin claimed that the Fed was designed to minimize panics and crises due to irregularities in flow of money supply and make the monetary system function more smoothly, but that a gold standard was too rigid.



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In 2013, Chairman Ben Bernanke likewise told college students that “financial stability concerns were a major reason why Congress decided to try to create a central bank in the beginning of the 20th century.”

Alas, from the beginning, reality diverged from Fed rhetoric. What the Fed claimed it did and would do sharply differed from what it actually did and from the consequences of its actions. Instead of preventing and ameliorating crises, it caused and aggravated them. Instead of fighting inflation, it was inflation’s fountainhead. Instead of remaining politically independent, it served politicians.

While it was originally claimed that the Fed would make financial and economic crises impossible by supplying an elastic money stock, in reality, from the beginning the Federal Reserve System was deliberately designed as an engine of inflation to be controlled and kept uniform by the central bank.

## Federal Reserve Reality

U.S. economic history clearly refutes the notion that the Fed merely maintained an elastic currency to satisfy only the needs of commerce. If that were so, one would expect no necessary long-term trend toward increasing inflation, yet that is what we see. The rate of annual increase of the monetary base has increased with each inflation-enhancing institutional change in our monetary system. From 1918 through 1933, the year Roosevelt took us off the domestic gold standard, the monetary base increased at an average annual rate of approximately 2.2%. From 1933 to 1971, when Nixon took the dollar off the last vestiges of the international gold standard, the monetary base increased at an average annual rate of 6.4%. After we left gold for good, the Fed increased the monetary base at an average annual rate of 9.8%.

The money stock followed suit. Since the advent of the Fed, M2 money stock increased by \$10,006.4 billion in 2012. That is over a 452% increase during the life of the Fed.

As one might expect as the money supply increased continually over the past century, the purchasing power of the dollar collapsed relative to what it was the century before the Fed. The consumer price index was 22.8 times higher in June 2013 than in January of 1913.

From 1800 to about 1895, the purchasing power of the dollar roughly doubled. Then, as prices began their long march up after the advent of the Fed, the dollar’s purchasing power began its long slide downward, culminating in a PPM (purchasing power of the monetary unit) of approximately 8 cents in 2009 compared to the dollar of 1800. So much for maintaining the value of the dollar, stable price, and manipulating the money supply only for the needs of commerce.

In light of the historical record, concerns about price deflation should be laughable. Noticeable price deflation has occurred only three times over the past one hundred years. The Fed allowed for price deflation in the wake of the 1920–21 recession, which is why it was over so quickly. It was ineffective in stopping monetary and price deflation in 1931–33 even though it was not for lack of trying.

## The Fed Fails to Prevent Crises

The financial meltdown of 2008 is merely the most recent economic debacle fostered by the Fed. Less than eight years

**CONTINUED ON PAGE 6**

# Austrians and the Mainstream

**John Cochran** looks at life for Austrians working in academia today.



Mises Institute Senior Fellow John P. Cochran recently spoke with the Mises Institute about his career. He offers some insights for Austrian scholars working in academia today.

**Mises Institute:** You recently retired after a long time at Metropolitan State University of Denver, where you were both an economics professor and the dean of the Business School. How did you end up there, and end up as dean?

**John Cochran:** I had a good guardian angel who helped me come to Metro State. I'm not sure about that on becoming dean, though. I received my undergraduate degree in economics from Metro State. Gerald Stone, then chair of the econ department, and Ralph Byrns were two of my professors there. As I worked on my graduate degrees at University of Colorado-Boulder, I would occasionally stop by Metro just to touch base. In spring 1981, I was just completing teaching my first principles course at UC-Boulder and had just completed the requirements for an MA in economics. The first edition of the Byrns and Stone principles book would be available for fall 2001. Metro had an open visiting position and had offered the job to a recent CU PhD. He had told them he would take their job, but wouldn't use their book. Ralph and Jerry were talking it over and Ralph said to Jerry, "We can't hire him." Jerry said, "We can't not hire him just because he said he won't use our book." Ralph replied, "But he is telling us he will be a 'lunch tax'." Jerry said, "Yes, but who else can we get?" [A "lunch tax" is a high-maintenance employee. — Ed.]

About that time I walked into the office to say hello. Ralph asked me three questions. Do you have a masters? Have you any teaching experience? When I said yes to both, Ralph, then asked, "Would you like a full-time teaching position this fall?" I have been at Metro ever since.

I taught from 1981 to 1986 in a visiting position as I completed my research on Hayek-Keynes and my dissertation which

eventually developed into a book I co-authored with Fred Glahe, *The Hayek-Keynes Debate: Lessons for Current Business Cycle Research* (Edwin Mellen Press, 1999). From 1986 to 2004 I taught in the economics department. I was tenured and promoted to associate professor in 1990 and promoted to professor in 1996. I served as chair of the department from 1990–1994 and then again from 1996 to 2004. I might say I was an accidental dean. Late in the fall of 2003, during the aftermath of the first boom-bust of the Great Moderation, Metro fired the dean of business. I was encouraged by many faculty members and staff to apply for the interim position. I was hesitant, but then realized I (and many others I respected) really did not want to work for any of the folks who either wanted or were being considered for the position. I applied and was appointed to the position perhaps a week before the start of the spring 2004 semester. What I thought would be a 6 month-to-a-year position lasted two-and-a-half years. I was hired as permanent dean in July 2006.

**MI:** There are now at least two Austrians at MSUD, Nicolás Cachanosky and Alexandre Padilla. Did you have a role in their coming to teach at MSUD?

**JC:** I had a direct role in hiring Alex Padilla. Metro State had a visiting position open for fall 2002. Hoping to attract an Austrian, I posted the job announcement on the Mises Institute scholars email list. Alex, a former Mises Fellow who was just finishing a stint at George Mason and had just published "Can Agency Theory Justify the Regulation of Insider Trading?" in *The Quarterly Journal of Austrian Economics*, applied, interviewed well, and was hired. He thrived in the position and I was able a couple of years later to use a recruitment tool to convert him to tenure track which began spring 2006. Padilla had more to do with bringing in Nicolás Cachanosky, who actually was hired into the position I vacated when I completed my transitional retirement in 2012. Alex chaired the search committee. There was at least

**CONTINUED ON PAGE 5**



## Mises Scholar and Alumni Notes



WALTER  
BLOCK

Senior Fellow **WALTER BLOCK** spoke at Columbia University in November on the legacies of Adam Smith, F.A. Hayek, and Ludwig von Mises.

Senior Fellow **ROBERT HIGGS** delivered a speech on “Wartime Prosperity” in October, and was filmed for three instructional videos in the history department at Liberty University in Lynchburg, Virginia. Also in October, he gave the final speech, on “Love, Hate, and the State,” to the regional conference of Students for Liberty in New Orleans. Dr. Higgs’s paper “Ronald Coase, Anomalous Superstar of the Economics Profession,” was published in the fall 2014 issue of *The Independent Review*.



ROBERT  
HIGGS

Senior Fellow **MARK THORNTON** was interviewed on several radio shows and podcasts, and on Press TV twice. He delivered a talk to the Auburn University economics club the Federalist Society of Montgomery, and represented the Mises Institute at Northwood University’s Freedom Week.

In the November 8 issue of *Wirtschaftswoche* (*Business Week Magazine*) in Germany, Senior Fellow **THORSTEN POLLEIT** wrote the “con” side of a published debate over whether or not the negative interest rate in Germany is a good thing. Dr. Polleit also delivered a talk about “Paper Money and Boom & Bust” at the second annual conference of the Ludwig von Mises Institut Deutschland held in Munich this year.



THORSTEN  
POLLEIT

Senior Fellow **GUIDO HÜLSMANN** provided the keynote lecture on error-cycle theory at a conference on “Entrepreneurship on Distorted Markets” at the University of Applied Economics in Krems, Austria. He also gave a talk on “The Political Economy of Finance” at the Institut für Wertewirtschaft in Vienna, Austria, and on September 13th, he gave a talk on “Fiat Money and Wealth” at the Property and Freedom Society in Bodrum, Turkey.



XAVIER

Former Mises Fellow **XAVIER MÉRA** is now an adjunct professor of economics at the Neoma Business School (Reims and Rouen, France) and at the IESEG Business School in Paris.

Associated Scholar **PAUL PRENTICE** gave a lecture, “Free People, Free Markets – Part I: The Moral Foundations of Capitalism,” at the Pikes Peak Economics Club in Colorado.



PAUL  
PRENTICE

Associated Scholar **DAVID HOWDEN** has published several new journal articles including “Unintended Consequences of China’s One-Child Policy,” with Yang Zhou in *Economic Affairs*; “Fiscal Considerations of Central Bank Recapitalization,” with Associated Scholar **PHILIPP BAGUS** in the *Journal of Prices & Markets*; “Central Bank Insolvency: Causes, Effects and Remedies,” with Philipp Bagus in the *Journal of Social, Political and Economic Studies*; and “Knowledge Flows and Insider Trading,” in the *Review of Austrian Economics*.



## Happy 90th Birthday, Leland B. Yeager!

In October, the Mises Institute hosted a reception in honor of the 90th birthday of Associated Scholar Leland B. Yeager, the Ludwig von Mises Professor of Economics, Emeritus, at Auburn University.

“Dr. Yeager is one of the more important monetary theorists of the mid-to-late 1900s,” writes Senior Fellow John Cochran. “Anyone, Austrian-leaning or not, who wants to comment on monetary matters should not do so until they have read and digested Yeager’s insightful work. *The Fluttering Veil* is a great collection of Yeager’s major contributions.”

## AUSTRIANS AND THE MAINSTREAM CONTINUED FROM PAGE 3

one member of the committee adamantly against an Austrian-influenced economist, no matter how good his scholarship and teaching accomplishments. Although just completing his PhD at Suffolk University under Ben Powell, Cachanosky's qualifications to date were clearly vastly superior to any others in the pool, which did include some George Mason graduates and ABDs. At Alex's request and as an emeritus prof, I reviewed the files of the top ten or so candidates. I then lobbied longtime colleagues on the committee, the department chair, and wrote a strong letter of support to the current dean of business. I look forward to excellent contributions to MSUD and the Denver community from both for many years ahead.

**MI:** Generally speaking, do other economists see a benefit from having a diversity of schools of thought within a department, or is there resistance to having Austrians on staff?

**JC:** Many economists do see an advantage in diversity. One of my dissertation advisors, Tracy Mott, now at the University of Denver, was an excellent role model as a gentleman and scholar. While his work focused on extending the ideas of Michal Kalecki and John Maynard Keynes on the relation of financial considerations to economic activity, he was open to disagreement and instrumental in my early research. While at DU, if he had students interested in Austrian economics he would occasionally have me or Padilla in to make a presentation.

In general, most good economists are looking for colleagues who are good scholars, good teachers, and not a lunch tax. Most of the Austrians I know and respect easily fit this bill. Obviously — from the comments above on the hiring of Professor Cachanosky — there can still be resistance. There can also be resistance from outside the economics department. I was denied promotion to professor the first time I

applied when the college wide review committee did not like my two papers with Fred Glahe on separating school and state ("Praxeology and the Development of Human Capital: The Separation of School and State," in *Cultural Dynamics* and "Privatization True and False: Private Enterprise and Education," in the *Journal of Private Enterprise*). The next year I promoted the papers as anti-voucher instead and flew through with flying colors.

**MI:** In a recent interview, Guido Hülsmann said that he's seen great progress in the ability of Austrian economists to get faculty positions at good (if not highly-elite) institutions. What are your observations here?

**JC:** Mine are more indirect, but I would tend to agree. Ben Powell has moved from San Jose State University, to Suffolk, and now to Texas Tech. More and more GMU grads are moving into positions with at least masters programs and some with respected PhD programs. During my term as dean at Metro State we had at least two (if not more) Austrian or fellow-traveler candidates whom we would have liked to hire, but we were not able to compete with other institutions with either salary, teaching load, or scholarly support. The Colorado mountains only buy so much.

**MI:** In the past, the availability of materials by Austrian economists — such as Rothbard's *History of Economic Thought* — was a real issue. What effect has the spread of affordable Austrian publications in the last twenty years had on the instructor's ability to engage students?

**JC:** I just received a short note from Lew Rockwell thanking me for being such a faithful donor since 1988. I became such a faithful donor because the great work the Institute was doing to make material available in print and online was benefiting me not only professionally in my scholarship, but was making it incredibly easier for me to engage students. Benefits for many extended beyond the classroom. Class handouts or a web link often stimulated curiosity and led at least some to become self-learners about Austrian economics and the philosophy of liberty.

Walter Block once sent me an email asking if I was a classical liberal or an anarcho-capitalist. I replied that it depended on how long it had been since I had read or re-read Rothbard (I would now add Robert Higgs's *Delusions of Power*). If recently, I was an anarcho-capitalist. But in my teaching, I was probably more of a classical liberal (although my intro lecture which highlighted the distinction between the political and economic means often would have at least one leftist/progressive in tears). I found it more effective with less tuning out. By using materials available at mises.org, students who were intrigued would, on their own, discover the anarcho-capitalist perspective. ■



Nicolás Cachanosky



Alexandre Padilla

## THE FED: REALITY VS. RHETORIC CONTINUED FROM PAGE 2

after its origin, a Fed-induced inflationary boom set in motion the recession of 1920–22. Fed inflation in the mid-to-late 1920s ushered in the recession that turned into the Great Depression. After World War II the Fed oversaw inflation and recession during the 1950s. By 1963 Fed-backed inflation so far outstripped the U.S. stock of gold that it was nowhere near large enough to cover our obligations under the Bretton Woods system. The situation was so bad, in fact, that the U.S. Treasury was compelled to borrow abroad in money other than dollars because of foreign lack of confidence in U.S. currency. The Fed prevented neither the stock market crash of 1987 nor the collapse of the hedge fund Long Term Capital Management. Immediately after the great stock market crash of 1987, then new Federal Reserve Chairman Greenspan, assured investors that the Fed stood ready to provide whatever liquidity was necessary to keep the markets afloat. The Fed's solution to the 1990s recession and Mexican Peso crisis was more of the same — monetary inflation via credit expansion.

Investors flush with new cash were looking for opportunities and became hip to the next big thing: technology and the internet. Fed inflation in the 1990s led to the tech-stock bubble and subsequent recession of 2000. The Fed again responded by doing what it does best: assuring investors, expanding credit and increasing the money supply and repeated its “accommodation” after the 9/11 terrorist attacks. Many investors, bitten by the tech crash and induced by various lending regulations, directed their new money into real estate and then mortgage backed securities and financial derivatives based on

these securities. Capital was malinvested again resulting in the Great Recession and the worst of crony capitalism.

Economic history demonstrates that not only has the Fed not provided economic stability, again and again it has introduced instability and economic destruction through its inflationary credit expansion and interest rate manipulation.

## Conclusion

For 100 years the Fed has proclaimed its economic indispensability. The picture it paints of a world without the Fed is a dystopian one in which society is left lurching from recession to recession, alternately experiencing runaway inflation and high unemployment. Thanks to the Fed, it is claimed, we instead enjoy sound money, fewer recessions, high employment, stable prices, and increased standards of living. In other words, the Fed is absolutely necessary for full-orbed macroeconomic stability.

Economic reality teaches a vastly different lesson, however, because the laws of economics have a way of impinging on statist rhetoric. The history of the Fed has been one of monetary inflation, higher overall prices, diminished purchasing power, economic depressions, and lost decades. In 1913 the state sowed the inflationist wind

and for a hundred years we have been reaping the economic whirlwind. ■



*Shawn Ritenour is professor of economics at Grove City College, an Associated Scholar at the Mises Institute, and a former Mises Fellow.*



If I look back at the events of the past 20 years and the career opportunities for Austrian economists, I see we've made huge progress. Today, it is possible for nearly all of our young PhD graduates to find a job at a university or college and it is increasingly possible to get jobs in well-ranked universities. And I think it will improve in the future. On the other hand, even if you're quite brilliant, very top schools may be biased against you as an Austrian. So there's always the sacrifice that you have to accept, and you need to be motivated by other things than personal success of a material sort ... you need to be motivated by the power of truth and the noble dignity of justice.

*Jörg Guido Hülsmann | Mises Weekends, July 31, 2014*



## IN MEMORIAM

We mourn the passing, but celebrate the lives and achievements, of these great supporters of liberty and the Mises Institute. Their far-sighted concern for the future of freedom will always inspire us.

Charter Member and longtime supporter **MS. PATRICIA HOKE BURROW** passed away in August of this year in Grand Junction, Colorado where she was known for her singing voice and work with the Sweet Adelines ensemble.

Charter Member **MR. THEODORE T. HADELER** passed away in Montvale, New Jersey. Mr. Hadelers graduated from MIT before a long career as an aerospace engineer.

## COMING EVENTS

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- SOUTHWEST REGIONAL MISES CIRCLE IN HOUSTON, TEXAS | January 24, 2015
- AUSTRIAN ECONOMICS RESEARCH CONFERENCE | March 12–14, 2015 | Mises Institute
- SEMINAR FOR HIGH SCHOOL AND COLLEGE STUDENTS | April 10, 2015 | Mises Institute
- NORTHEAST REGIONAL MISES CIRCLE IN STAMFORD, CONNECTICUT | May 14, 2015
- ROTHBARD GRADUATE SEMINAR | June 7–12, 2015 | Mises Institute
- MISES UNIVERSITY | July 19–25, 2015 | Mises Institute

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