

The

FREEMarket

PUBLISHED 12 TIMES PER YEAR BY THE LUDWIG VON MISES INSTITUTE

How Far Will We Fall?

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Many people are rightly concerned about economic conditions, which are far more grim than the official statistics suggest. Young people out of college are facing a stagnant job market. Businesses have rethought expansion plans. Retrenchment continues to be the watchword in nearly every area of commercial life.

It is one thing to deal with recession. But there is something more fundamental taking place, or so it seems. Are we facing a future in which lower living standards are the long-term trend, with ever future opportunities for a broad-based economic growth?

Let's examine Mises's analysis of the relationship between capital accumulation and economic growth. One thing that sets Austrian economics apart from the mainstream is the Austrian School's careful analysis of the structure of production. When an Austrian economist considers the structure of production, he doesn't just dwell on crude aggregates, such as the total number or total value of capital goods in an economy. Rather, he considers how long (or how "roundabout") a given structure of production is.

An Austrian economist asks, "How many steps are there in the production process between the extraction of raw resources and the actual output of consumers' goods?" He also considers how any given society with a given structure of production can improve its productivity.

Any change in the structure of production obviously must either involve an increase, decrease, or maintenance of its *length*. Improvements in productivity that involve *less* or *equally* roundabout production processes will tend to be adopted very quickly because they tend to require fewer resources. Therefore, all that is required for their adoption is their discovery. For example, it won't take long for a hunting society to realize that the hard, sharp obsidian in the area is better for skinning animals than the fragile, blunt pumice stones they may have tried to use first.



But once a society has plucked all the low-hanging fruit of “no-brainer” productivity improvements, what then can its members do to improve productivity? The only thing left to do would be to adopt improvements in productivity that involve *more* roundabout methods of production.

For example, a hunting society might try the more roundabout (but more productive) method of making and using bows and arrows for hunting to replace the less roundabout (but less productive) method of making and using crude spears. This is an investment in more-productive capital goods.

However, since making bows and arrows takes more time, and perhaps more resources, the hunters and their investment must be sustained by an adequate stock of food and other materials; even though the bows and arrows will yield a greater bounty, they will only do so after a *longer period of time*. Thus, savings are an indispensable prerequisite for increases in productivity that involve lengthening the structure of production.

As Ludwig von Mises explained in *Human Action*: “The *sine qua non* of any lengthening of the process of production adopted is saving, i.e., an excess of current production over current consumption. Saving is the first step on the way toward improvement of material well-being and toward every further progress on this way.”

Such “further progress” is possible due to the fact that more-bountiful

production methods mean more goods, which in turn mean a greater capacity for savings. The new saved goods can be used, not only to maintain the new, longer structure of production (by replacing bows and arrows as they are spent), but can also be used to support an even longer and more bountiful structure of production (say, in the case of the hunters, building and using extensive traps).

The savings made possible by the second productivity-enhancing lengthening of the chain of production can then in turn be used for a third such lengthening, and so on. In a free market, this virtuous cycle of capital accumulation can go on in perpetuity, thus engendering an upward spiral in the well-being of mankind.

But as Mises wrote later in the same section, no matter how high up the spiral we may be, we always owe the propitious opportunities at hand to the capital accumulation of those who came before us.

“Every single performance in this ceaseless pursuit of wealth production is based upon the saving and the preparatory work of earlier generations,” he wrote. “We favorite children of the age of electricity still derive advantage from the original saving of the primitive fishermen who, in producing the first nets and canoes, devoted a part of their working time to provision for a remoter future. If the sons of these legendary fishermen had worn out these intermediary products—nets and canoes—without replacing them by

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Editor: Jeffrey A. Tucker

Contributing editors: Thomas J. DiLorenzo, Jeffrey M. Herbener, Robert Higgs, Mark Thornton

Publisher: Douglas E. French

The Free Market is published 12 times a year.

Note: the views expressed in the Free Market are not necessarily those of the Ludwig von Mises Institute.

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new ones, they would have consumed capital and the process of saving and capital accumulation would have had to start afresh.”

It is just such an upward spiral that the Western world experienced during the Industrial Revolution. The rapid rise in Western living standards during that time was a function of *capital accumulation*. “The start which the peoples of the West have gained over the other peoples,” explains Mises, “consists in the fact that they have long since created the political and institutional conditions required for a smooth and by-and-large uninterrupted progress of the process of larger-scale saving, capital accumulation, and investment.”

What ultimately matters for the well-being of society is the degree to which our wants are satisfied, and therefore the *actual* usefulness of goods. Of course, we can only know the actual usefulness of goods in hindsight. Acting man, therefore, must rely on his *anticipation* of their actual usefulness.

Of course, man is not prescient, so he will often err in his anticipations. The more he errs, the more he will adopt structures of production that are either not as capital intensive (and productive) as he could have afforded, or more capital intensive than he can sustain and see through to completion. As an example of the latter, a hunter who incorrectly measured the length of rope in his possession might embark on building a kind of trap that required more rope than he actually had. He would, of course, be unable to finish the trap, and any of the rope that was cut into lengths unusable for anything else will have been wasted.

Central Banks and Social Retrogression

The Austrian business cycle theory, first formulated by Mises in 1912, teaches us that in a developed economy,

artificial expansions of the supply of money and credit (which now are the exclusive prerogatives of central banks) temporarily lower the rate of interest, which leads to mass error. It causes people to think, like the hunter with poor rope-measuring skills, that they are wealthier than they truly are, which leads them to overconsume and to invest in production processes which are too ambitious given the capital goods available.

Let’s say a hunting society using crude spears is at level 1 of capital accumulation. Bows and arrows are used at level 2, and traps at level 3. Using such a scale, an industrial society would have to be characterized as being several orders of magnitude above these levels. But, let’s just say, for simplicity’s sake, that in the early phases of its first industrial revolution, a given society was at level 8 of capital accumulation, and it subsequently advanced to level 9, then 10, and so on.

Now, let’s say that the society at some point is cursed with a central bank. At the time of the central bank’s first expansion of money and credit, the society is at level 10. Again, artificial expansion of the supply of money and credit makes the members of society think they are at a more advanced level than they really are. It makes them think they have sufficient capital goods to see through longer, more productive production processes, when they really don’t.

And so let’s say the monetary expansion is sufficient to make the members of the society think they are at level 11, instead of level 10. They make level 11-appropriate investments, which are simply unsustainable. The society is going through an economic bubble. The reality of the situation will eventually reveal itself to the members of society. That is the moment of the “bursting of the bubble.”

Now you might think it would then simply be a matter of reallocating the capital to level 10—appropriate production processes. But that presupposes that capital is an amorphous blob, like a mass of clay, which can be divided up and merged together to any purpose. But just as the shaft of a curved bow makes a wretched spear, and much of the materials of an animal trap are useless for the production of bows, most of the investments made during a bubble are simply lost.

And so, having squandered its resources, our hypothetical society, which was acting as if it were at level 11, is likely to find itself taking multiple steps back. It may, at best, need to adopt level 9—appropriate methods of production.

That is, of course, unless the central bank expands money and credit even further, making people think level 11 is still viable. Then they will just continue to squander resources and drop level after level until the central bank finally leaves bad enough alone.

And of course it is not just how long the central bank fosters malinvestment that matters, but how *intensely* it does so. The greater the degree to which the central bank expands money and credit, the worse will be the resulting malinvestments. An unsound production process adopted by a businessman who thinks he's three times as wealthy as he really is will squander *more* resources than one adopted by a businessman who thinks he's only two times as wealthy as he really is.

Our Present Crisis of Interventionism

What does this mean for us in our present situation? The longevity and the intensity of the monetary and credit expansion embarked upon by the Federal Reserve since the beginning of Alan Greenspan's term has been

unprecedented. Even compared to the Hoover-Roosevelt era, what Greenspan did after the dot-com bubble burst, and what Ben Bernanke did following the bursting of the housing bubble, was stratospheric. Bernanke tripled the Fed's balance sheet. Through engendering massive capital consumption, these measures have destroyed prodigious amounts of wealth, and continue to do so today.

Regarding the true wealth of society, nobody can say exactly how many "levels" we've fallen, or will fall. But it will very likely be enough to result in a calamitous long-term plummet in the living standards of the average person. This will very likely bring us to the climax of what Mises called the "Crisis of Interventionism."

Before the rise of liberalism made continuous capital accumulation possible across generations, the common man held a gross underestimation of what his own species was capable of. He took it for granted that economic stagnation across millennia was simply an inevitable fact of life. He had no inkling that human society was capable of enormous strides in the standard of living within a *single decade*. If the average man had any notion of it at all, he would have shrugged at the fact that his own standard of living was not much different from that of the average man a dozen generations before him, or, for that matter, from an even more ancient forebear 1,000 years prior. And if the ruling caste lived high on the hog while the bulk of the populace remained mired in squalor, well that was just a fact of life, too.

But that has irreversibly changed. The phenomenal increases in the well-being of man over the past centuries have exploded such lies. The common man knows he and his fellows are capable of wondrous achievements.

And so, years from now, after the prodigious capital consumption

engendered by the Federal Reserve and other government measures has reduced society to squalor again, the common man will not accept it. The ruling caste may insist to him that the new squalor is simply a product of circumstances brought on by the recklessness of certain private individuals, and that the maintenance of the rulers' own power and position are necessary to keep things from getting even worse (as the Fed is doing even now as it is confronted with but a mild curtailment of its powers).

But the common man will not believe these lies. He will not accept a return to the old order. He has already tasted the fruits of capital accumulation. He knows civilization is capable of more than this, and that somewhere there *must* be a wrench in the gears of society: a problem too fundamental to be explained by just the reckless investing or heedless consumption of certain private individuals at a certain point in time.

He will desperately look for this wrench, even if it means abandoning some of his most firmly held beliefs about government and society. He already knows from history that the students of Marx can't help him find it. And he will come to realize after a string of failed economic rescue attempts that the students of Keynes and other mainstream economists don't know where it is either.

But, if he survives long enough, and if society does not descend into barbarism first, the common man might find the answer to his conundrum in the writings of Ludwig von Mises and his students. And he will learn from Mises that the wrench in the gears of civilization is nothing else but the interventionist state. He might even then find the will and the nerve to yank out the wrench for good.

Or he might not, and all will be lost.

As the state brings the world deeper into the crisis of interventionism, civilization itself is nearing a fork in the road. It will be Mises or bust. ■ FM

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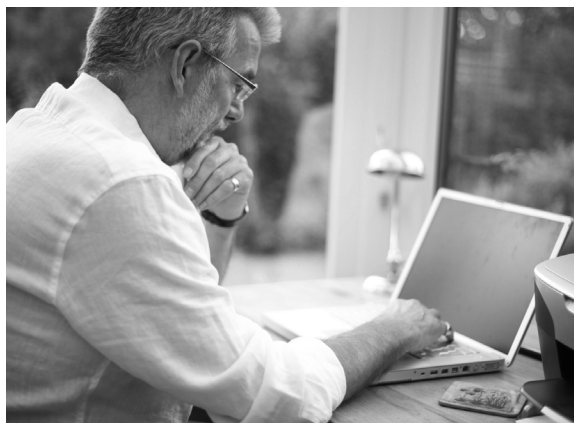
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News from the Institute

The Mises Academy

The Mises Academy has a wonderful line-up of fall classes that you can attend. Students throughout the spring and summer have given rave reviews of the Mises Academy, with its live classroom environment, along with a well-developed environment for interaction with fellow students, testing, grading, and extensive interaction with the best faculty in the world. It is the future of learning, and the Mises Institute is on the cutting edge. Please consider joining us this fall for one or several of our classes, which are open to everyone.

Principles of Economics is taught by Robert Murphy, and is based on his new textbook for high-school students: The class will run from September 7 until November 19, ten weeks of fantastic economics instruction from the ground up. His book, which is sure to become a standard text in the future, will be debuted in this class. Enrollment in the class is \$250 and covers all materials, weekly lectures, office hours, quizzes, grading, and final exam. The class is designed for high-school students, but it is the ideal class for gaining a solid foundation in economic science. The focus is on the Austrian understanding. The knowledge gained will establish a rock-solid basis for all future studies in economics.



The New Deal: History, Economics, and Law is taught by Thomas E. Woods, Jr. The class runs from September 6 through October 22, 2010. It examines the critical period of American history from the stock market crash of 1929 to the end of World War II, focusing on domestic affairs. Topics include: the 1920s boom and bust, the Hoover record in light of recent scholarship, the New Deal programs and agencies, the evolution of the Supreme Court, international parallels, political and intellectual opposition to FDR, and the economic consequences of World War II. Readings include primary documents, works by contemporaries, and recent scholarship and commentary.

Freedom Versus Authority: Europe 1789–1945 is taught by David Gordon. This class runs from September 16 through November 11, 2010. It examines the critical period of European history from the French Revolution to the end of World War II. Readings include primary documents, works by contemporaries, and recent scholarship and commentary.

The Political Economy of War is taught by Thomas J. DiLorenzo. The class runs from September 20 through November 24, 2010. It examines the economic

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- THE MISES CIRCLE AT FURMAN UNIVERSITY
November 13 • Furman University, South Carolina • Sponsored by Atlantic Bullion & Coin, Professional Planning of Easley, LLC, and Furman University Conservative Students for a Better Tomorrow
- ECONOMICS FOR THE YOUNG STUDENT — SEMINAR FOR HIGH-SCHOOL STUDENTS
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- ECONOMICS IN ONE LESSON — SEMINAR FOR HIGH-SCHOOL STUDENTS
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- THE MISES CIRCLE IN NAPLES, FLORIDA
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July 24–30, 2011 • Mises Institute
- THE MISES CIRCLE IN NEW ORLEANS
September 10, 2011 • New Orleans, Louisiana

causes and consequences of war, such as the myths of “wartime prosperity” and “nation building”; economic interventionism as a cause of war; and the costs of war.

The Economics of Private Legal and Defense Services is taught by Robert Murphy. This class explores what is for many libertarians, the ultimate logical extension of libertarianism: the private provision of security. ■ FM

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