

BOOK REVIEW

THE GREAT DEFORMATION: THE CORRUPTION OF CAPITALISM IN AMERICA

DAVID A. STOCKMAN

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The Great Transformation is a *Human Action*-sized treatise about how the Fed over the past several decades has generated economic instability in far more ways than even the Austrian Business Cycle theory contends, primarily for the benefit of Wall Street One-Percenters at the expense of the rest of society. It has cemented into place neo-mercantilism as the American economic system. In many ways the book can be thought of as “*Human Action* for Financial Markets” (which is not to suggest that Mises would agree with everything in the book). It is a treasure trove of ideas for future research on financial markets and regulation from an Austrian perspective.

David Stockman not only cites Mises and Hazlitt, among other Austrians, but is also a severe critic of the supposedly free-market

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Chicago School of monetarism and its patron saint, Milton Friedman. In fact, he pins a large share of the blame for the corruption of American capitalism on Friedman as a preeminent defender of the Fed with his utopian and cultish “monetary rule.” (If anything defined twentieth-century monetarism, it was Friedman’s “monetary rule” of 3 percent monetary growth per year, administered presumably by what Stockman calls monetary “eunuchs”).

The main theme of *The Great Deformation* is stated clearly on the first page of the introduction, where Stockman explains how “fiscal cliffs as far as the eye can see” are “the result of the capture of the state, especially its central bank, the Federal Reserve, by crony capitalist forces deeply inimical to free markets and democracy.” This statement suggests a great irony in that it was the “Chicago School” economists who championed the “capture theory of regulation” with regard to such industries as interstate trucking and airlines, but ignored the biggest and most important regulatory capture of all—the creation of the Fed.

Stockman’s unique background and experience have allowed him to write authoritatively and with great knowledge the mountain of lies—about “too big to fail,” Reaganomics, the New Deal, and the antics of the Fed—that have been employed by Washington’s central planners who have succeeded in essentially destroying much of American capitalism and replacing it with putrid political cronyism. This is a man who was once a member of Congress and the director of the U.S. Office of Management and Budget during the first four years of the Reagan administration. Since then, he has been a consummate Wall Street insider, first with Salomon Brothers and then as a private equity investor with The Blackstone Group. He is also very well read in economics and economic history. It is doubtful that any other human being has a comparable combination of talents. Only David Stockman could have written this book, in other words.

CORPORATE WELFARE RUN AMOK

Part I debunks the lies perpetrated by Washington to justify the bailouts of Wall Street (and other industries) in the wake of the “Great Recession” that was created by the Greenspan Fed with the “help” of myriad other federal government policies. For example, there was never any reason for the government to bail

out Goldman Sachs. After being handed \$10 billion the company “swiveled on a dime and generated a \$29 billion financial surplus” which included \$16 billion in salary and bonuses just three months after the bailout to supposedly “save it from extinction.”

Nor was a bailout of the insurance company, AIG necessary. At the time, Stockman writes, 90 percent of AIG was solvent, yet it was handed \$180 billion in taxpayer funds. The sole purpose of the bailouts, Stockman documents, was “all about protecting short-term earnings and current-year executive and trader bonuses.” In other words, the sole purpose of the government’s monetary and fiscal policies during that time was to guarantee the eye-popping bonuses that Wall Street One-Percenters paid to themselves to guarantee that these extraordinarily wealthy multimillionaires would continue to flood the Democratic and Republican Parties with campaign “contributions” to help guarantee the reelection of every last congressional incumbent.

Nor was there any “systemic risk” caused by the capitalist system, as Ben Bernanke immediately suggested after the crash of 2008. There is “no proof of this novel doctrine whatsoever,” writes Stockman, who dismisses Bernanke’s notion that “capitalism was actually a self-destroying doomsday machine.” It was the Greenspan Fed that “conducted a subtle assault on free-market capitalism” with its impulsive central planning. The “Greenspan Put” is the policy of the Fed pumping more and more liquidity into the system whenever stock prices on Wall Street failed to increase as much as the politically-connected traders wanted them to. One consequence was the dot-com bubble in which the NASDAQ reached an average of 100 times earnings. Greenspan’s successor, Ben Bernanke, continued the Fed’s slavish devotion to the Number One Goal of preserving the multi-million dollar bonuses of Wall Street One Percenters with “the Bernanke Put.” Stockman disproves the self-serving argument made by the Fed and its Wall Street comrades that losses in the stock market will always necessarily spill over into the real economy.

REPUBLICANS VS. THE FREE MARKET

Part II of *The Great Deformation* takes the Republican Party to the woodshed, so to speak, by demonstrating its complicity in “the

triumph of the welfare state" and its disastrous championing of the warfare state at the same time. Stockman begins by reminding his readers that the "Troubled Asset Relief Program" (TARP) that needlessly bailed out the big Wall Street banks was started by the Republican administration of George W. Bush and was "a stark repudiation of the Reagan Revolution" that Republicans love to rhapsodize about. Government spending during the second Bush administration "dwarfed all prior episodes of profligacy" as "the public debt tripled and Federal red ink amounted to nearly 70 percent of GDP growth" during the twelve years of Presidents Reagan and George H. W. Bush.

Reagan's biggest mistake, according to Stockman, was to appoint the Wall Street hack/Republican hanger-on Alan Greenspan as Fed chairman. Greenspan's central planning proclivities institutionalized "a statist regime through the back door of activist monetary policy" as "bubble finance became a substitute for real income and production."

Stockman also notes how the Reagan defense buildup, which occurred as the Cold War was essentially over, provided the military-industrial-congressional complex with so many resources that "future presidents were thus equipped to launch needless wars of invasion and occupation" thanks to the "Reagan armada." The weapons produced during the Reagan years were of little or no use in any nuclear war, which was the fear at the time, but "were well suited to imperialistic missions of invasion and occupation." In fact, Stockman argues that *none* of the Reagan defense buildup impacted the "strategic nuclear equation"; hence, "the idea that the Reagan defense buildup somehow spent the Soviet Union into collapse is a legend of remarkable untruth."

As for the welfare state, Stockman points out that Reagan did sign into law a half dozen tax increases after the initial 1981–1983 tax cuts, which rendered him "the tax collector for the welfare state" when all was said and done.

The most scathing condemnation of the Republican Party occurs in Stockman's seventh chapter, in which he explains how "free-market" economists like Milton Friedman and George Shultz ("who had... perfected his patented craft of explaining things to presidents exactly as they preferred to hear them") supported

Richard Nixon's decision to separate the dollar from gold once and for all in 1972. The result was "a forty-year spree of global debt creation, financial speculation, and massive economic imbalance..." The main purpose of Nixon's election-year decision was to eliminate any and all constraints on federal spending in the short term to ensure his reelection. It worked well for him.

DEBUNKING NEW DEAL MYTHOLOGY

The third part of *The Great Deformation* is devoted to debunking various New Deal myths that have long been used to support statism and interventionism. The New Deal "did not end the Great Depression or save capitalism from the alleged shortcomings which led to the crash," Stockman writes. He rightfully mocks FDR's asinine belief that the Great Depression was caused by "low prices," so that government-imposed price supports would supposedly cure it. Nor did the New Deal have anything to do with Keynesian "demand management." FDR did meet Keynes once, but came out of the meeting bewildered and uninformed.

There was no need for FDR's famous "bank holiday," for there were thousands of failed banks that were insolvent and should have been closed, writes Stockman. The "banking crisis," he writes, was essentially over even before FDR was inaugurated in 1933. Moreover, the massive "public works" spending of the New Deal did not end the Great Depression but only destroyed private-sector jobs while "creating" far fewer government "jobs." It was all mostly a scheme to buy votes to get FDR reelected time and again.

Far from being the scourge of crony capitalists, FDR was their best friend, as his National Recovery Administration was nothing more than a giant, government-enforced price-fixing scheme. Keynes, meanwhile, was busy praising Hitlerian autarky during the late 1930s, as Stockman shows. He quotes Keynes as saying "I sympathize... with those who would minimize... economic entanglements between the nations." Accordingly, Keynes believed that Nazi Germany was the most hospitable country to his central planning schemes.

Stockman has praise for Presidents Harry Truman and Dwight D. Eisenhower. The former probably shortened the Korean

War by insisting that most of it be financed with taxes, whereas Eisenhower shrunk the U.S. Army by about 40 percent with a one-third reduction in military spending during his terms in office. Strangelovian generals Matthew Ridgeway and Maxwell Taylor resigned in protest of no new Korean Wars on the horizon.

THE CHICAGO SCHOOL OF FAUX-MARKET ECONOMICS

Stockman brilliantly critiques many of the establishment economists for their cluelessness about the economy. Ben Bernanke's "sole contribution" to economic scholarship, he writes, was "a few essays consisting mainly of dense math equations. They showed the undeniable correlation between the collapse of GDP and the money supply, but proved no causation whatsoever." He calls out Ed Lazear of Stanford, the chairman of the president's council of economic advisors under President George W. Bush, for saying in May of 2008 that "the data are pretty clear that we are not in a recession." When the "Wall Street meltdown" happened, Lazear "did not have the foggiest notion of why it happened."

But Stockman reserves his sharpest critiques for Milton Friedman and the Chicago School monetarists, concluding that they were never much more than a cult that believed in a dubious *a priori* assumption despite all their chatter about empiricism and positivism. If Friedmanite monetarism was anything, it was naïve about political economy. The fatal flaw of Friedman's famous "monetary rule" of constant three percent monetary growth was that it was premised on the assumption that a machine-like Fed chairman would selflessly promote the public interest by imposing Friedman's rule. In this regard, Friedman and his fellow Chicagoans were no different from Samuelsonian statisticians. Thus, Friedman's monetary rule was "basically academic poppycock," writes Stockman. It was "sheer fantasy" to believe that "the FOMC would function as faithful monetary eunuchs, keeping their eyes on the M1 gauge and deftly adjusting the dial in either direction upon any deviation from the 3 percent target."

Friedman also "thoroughly misunderstood the Great Depression and concluded erroneously that undue regard for the gold standard rules by the Fed during 1929–1933 had resulted in its failure to conduct aggressive open market purchases of government

debt..." Moreover, contrary to Friedman's assertions, "there was no liquidity shortage" during that period as "commercial banks were not constrained at all in their ability to make loans or generate demand deposits.... Friedman thus sided with the central planners... in contending that the... thousands of banks that already had excess reserves should have been doused with more and still more reserves..." "There is simply no case that monetary stringency caused the Great Depression," as Friedman and Schwartz claimed.

"The great contraction of 1929–1933 was rooted in the bubble of debt and financial speculation that built up in the years before 1929," writes Stockman, repeating the theme of Murray Rothbard's *America's Great Depression*.

THE AGE OF FED BUBBLES, BOOMS, AND BUSTS

Part IV of *The Great Deformation* holds great promise as a fount of research ideas for Austrians. Here Stockman offers dozens—perhaps hundreds—of examples of how the Fed's inflationary finance distorts markets and destroys real capitalism. In a nutshell, when Nixon detached the dollar from gold once and for all in 1972, he ushered in several decades of central planning by the Fed that created enormous instability in all financial markets, giving rise to rampant speculation based not on the realities of markets but on speculative hunches on what the Fed's next move might be. Speculation on the free market has the effect of stabilizing prices when speculators take goods off the market when they buy low (with futures contracts), thereby increasing prices, and then selling when prices are higher, causing prices to moderate. Speculation based on bets regarding Fed behavior is totally different: it is not unlike a gambling casino and creates price *instability*—especially when it comes to interest rates.

As Stockman writes, under the gold standard interest rates changed "at a glacial pace" for many decades. In the post-1972 era, "radical fluctuations in exchange rates and interest rates became routine occurrences" thanks to incessant Fed tinkering and central planning. Always and everywhere, the Fed's creation of bubbles in oil, natural gas, commodity, and other markets was geared toward providing some kind of veiled corporate welfare

for the corporations that dominated those markets. Stockman entertainingly points out that the periodic successes of companies like Procter and Gamble and General Electric were not so much the result of the brilliant management skills of CEOs like Jack Welch, but were caused by the cheap credit orchestrated by Fed central planners. When the bubbles burst, as they inevitably do, the Fed would attempt to create even more bubbles with more "liquidity." The Fed is therefore the ultimate practitioner of pork-barrel politics and is anything but "independent" of politics.

All of this means that the leftist academics who complain about "wasteful speculation" may have a point even if they do not realize it themselves. Fed-induced speculation is indeed economically wasteful and destructive; free-market speculation is not.

A WAY OUT?

Stockman concludes with thirteen policy proposals that he says are "compelling" but "would never be adopted in today's regime of money politics, fast-money speculation, and Keynesian economics." They are almost all very sound and conducive to the free market. He suggests a path to returning to a gold-backed dollar; the abolition of deposit insurance and the moral hazard problems it causes; the abolition of congressional incumbency through term limits; and a requirement to balance the federal budget. The latter is problematic since it gives Congress an excuse to raise economically destructive taxes for the sake of budgetary balance.

Stockman would end macroeconomic central planning if he were king, and abolish social security, bailouts, and corporate welfare. Ten federal agencies would be scrapped, along with the minimum wage.

Some of his more dubious proposals are to replace the income tax with a consumption tax, although as Murray Rothbard has shown, a "consumption tax" also inevitably deters savings and taxes one's income, albeit not as directly as a personal income tax. The imposition of a wealth tax to "pay down the national debt" a bad idea, but replacing the "warfare state" with genuine national defense is something that would allow trillions to be taken out of the government's hands.

The ultimate goal, says Stockman, is to repeal the evils set in motion by the New Deal era, "namely, that in pursuing humanitarian purposes the state cannot and need not attempt to manage the business cycle or goose the free market with stimulants for more growth and jobs; nor can it afford the universal entitlements of social insurance."

