POLICY REPORT

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Inflation, Recession, and Macroeconomic Policy

by Richard E. Wagner

Numerous sources these days, government and private, are predicting that we are headed for a recession, if we are not already in one. The recent increase in OPEC prices seems to have removed any doubts about this prediction from most people's minds. Thus attention has turned once again to the possible use of expansionary policies to offset the expected recession. This common approach to macroeconomic policy, both the economic foundations on which it is based and the political presuppositions that underlie it, will be reconsidered in this essay.

Inflation and Recession as Alternative Conditions

The perspective that has provided the foundation for macroeconomic policy since World War II is based on three main premises. First, the economy faces a trade-off between the rate of inflation and the rate of unemployment, and this trade-off constrains the options open to policy-makers. Second, inflation and recession (unemployment) result from changes in aggregate spending, a premise which leads to a belief that policies that offset these changes in spending can counteract these conditions. Third, the process of public policy formation will necessarily work as best as can be expected to promote economic stability. The tools of economic policy will be put to the best use possible, limited only by ignorance (on the part of economists), error (a bad set of survey data), or unforeseen events (recalcitrant Arabs).

In the Phillips curve framework, inflation and recession (unemployment) are regarded as alternative maladies.[1] Recession means unemployment and excess capacity, which can be offset by policies that increase spending. Inflation means that there is excessive demand placed on labor and industrial capacity, which can be counteracted by policies that decrease spending. The fiscal-monetary approaches used within the Phillips curve framework seem deceptively appealing at first glance, possibly because of their stark simplicity. If the economy becomes overheated (inflation), it becomes the task of policy to cool it down by reducing the amount of spending. If the economy becomes sluggish (recession), it becomes the task of policy to quicken the pace of activity by increasing the amount of spending. Put somewhat differently, an economy is like an inflatable ball. When the air pressure threatens to become great enough to burst the ball, policy should remove some air. When the air pressure threatens to become so low that the ball will not bounce, policy should increase the air pressure. Like controlling the air pressure in a ball, the task of controlling inflation or recession is essentially a relatively simple matter. While it would be agreed that it is more difficult to keep an economy on an even keel than it is to keep the proper amount of air in a ball, the important point is that the task possesses the same simple structure in both cases.

> **"If the problem of economic management is truly as simple as the Phillips curve framework implies, how is it possible that we have as much economic disorder as we observe all about us?"**

Recession as a Cause of Inflation

If the problem of economic management is truly as simple as the Phillips curve framework implies, how is it possible that we have as much economic disorder as we observe all about us? Perhaps the mechanistic framework of aggregate demand management does not properly capture the central features of an economy and of the problem of economic management. The standard framework sees inflation and recession as inversely related, with both magnitudes determined contemporaneously by public policy. But this view does not square with our recent experience, nor is it a reasonable description of a complex economy. There is good basis for suggesting that inflation and recession are directly related, but only in a time-dependent sequence in which inflation is a cause of recession.

To understand how inflation is a cause of recession, it is necessary to understand that monetary expansion has two consequences. One is an increase in the pace of economic activity

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EDITORIAL

If Coffee, Why Not Oil?

by Richard E. Wagner

Remember the coffee shortage a few years ago? Between 1974 and 1976, the output of coffee fell by nearly 25 percent. Despite this enormous decline, no national trauma or hysteria resulted, and we didn't have to wait in lines to buy coffee. Our politicians did not flirt with rationing, nor did they consider placing special taxes on coffee companies. There wasn't even any effort to control the amount of coffee served in public places, say, by limiting each customer to one refill. The coffee shortage just didn't create much excitement. The price of coffee simply went up, and people drank less coffee or made their coffee weaker or drank more tea. Coffee became scarcer and more expensive, but we could always depend on having it if we desired.

Why is our ability to buy gasoline in such jeopardy? Much effort in Washington seems directed toward assuring us an adequate gas supply. It has now been nearly six years since President Nixon imposed the 55-mile-per-hour speed limit. President Carter has now decreed that air conditioners be set for a 78-degree temperature, a concession from the 80 degrees the Department of Energy wished to impose. Moreover, there is a growing interest in rationing, the Congress is considering a special tax on the profits of oil companies, and there are numerous other possible policies in the offing. But nothing like this happened when the output of coffee fell so drastically. Congress created no bureau to take responsibility for assuring us of adequate supplies of coffee. We were dependent upon the workings of the market process, in which firms seek profits and customers seek the best buys for themselves. By contrast, the oil industry had de facto become practically a nationalized industry. Through 3,000 pages of regulations, the Department of Energy directs about 300 million gallons of gasoline daily to the 200,000 gasoline retailers in the nation. Might there be a lesson to learn here?

Probably the most fundamental proposition of economics is that it is *impossible* for any central agency to direct the production and distribution activities of a complex economy. The effective production and distribution of oil, or of any other product, will depend upon knowledge contained in the minds of millions of people throughout the world. No computer is capable of storing, digesting, and acting upon this required knowledge. Moreover, effective economic conduct will also depend upon the experienced judgments and intuitions of the participants—necessary ingredients that, by their very nature, cannot be transmitted to a central agency.

Central direction of the production and distribution of oil, because it replaces knowledge with ignorance, is less effective than letting consumers and suppliers act in their own interests. Who ever heard of too much coffee in some places and not enough in others? It could happen only with central direction. In a market setting, people specialize in knowing different things, and the total amount of knowledge brought to bear on economic events is the sum of these specialized pieces of knowledge. With central direction, this specialized knowledge is necessarily filtered and reduced as it moves upward in the chain of command; the operation of the industry thus comes to be governed by a considerably reduced and distorted body of knowledge. Consequently, production and distribution will take place less effectively than they would if there were no central direction. Trying to do the impossible can only make matters worse.

Wise policy knows the limits of policy, and works within those limits, one of which is the limit on the amount of knowledge that can be possessed by any one person, center, or agency. It is simply impossible to gather the knowledge required to institute effective central direction, and the effort to direct can only create disruption. Our energy troubles have been worsening precisely as we have been increasingly nationalizing the production and distribution of energy, and the direction of causation runs from nationalization to trouble. The reason for this pattern of causation is explained by one of the cardinal principles of economics, a principle that can be violated only at the price of disruption and stagnation. We didn't violate it for coffee. Wouldn't it be nice if we could hear as little about oil as we heard about coffee?

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because people have more money to spend. The other is a change in the pattern of economic activity because the newly created money is injected at particular points in the economy. The monetary expansion will favor some people and some areas of the economy over others. With the new spending concentrated in certain sectors of the economy, the prices of particular products and inputs will rise relative to others, in addition to the general rise in prices due to the money creation.[2]

To an important extent this shift in prices will favor the producer goods industries relative to the consumer goods industries. A central feature of an economy is its vertical structure of production, ranging from consumer goods, which are goods closest in time to final consumption, to producer goods of the highest order, which are goods furthest in time from final consumption. Bread in a bakery or grocery store would be a consumer good. Flour in a bakery would be a producer good, though one of relatively low order. Wheat at a miller's would be still further removed from final consumption as bread. And land suitable for growing wheat would be yet a higher-order producer good. There are a number of ways monetary expansion can alter prices, an important one being a lower price of credit: In our fractional reserve system of banking, monetary expansion takes place to an important extent through the ability of banks to expand their loans as a result of Federal Reserve purchases of government debt. By lowering the price of loans, this process of credit expansion encourages investment in the producer goods industries, particularly those of relatively high order, because it is these long-term projects which are most sensitive to interest rate changes and the supply of loanable funds. While there will be a general increase in spending, there will be some concentration of this spending in the producer goods industries.

"A growing number of analysts, however, have suggested that there is a bias within the prevailing institutional order through which policy emerges that tends to produce economic disruption."

While money creation initially quickens the pace of economic activity, it also creates the conditions for a subsequent recession.[3] The money expansion makes investment in producer goods industries more profitable than formerly. The increased production of producer goods, however, initially implies a reduction in the production of consumer goods. Yet people have not increased their willingness to save, which means that their desire to consume is unchanged. The rise in incomes actually increases the demand for consumer goods. Consequently, the prices of consumer goods will start to rise, which in turn will increase the profitability of investment in consumer goods industries. Contraction will take place in the producer goods industries as resources are attracted into the production of consumer goods. As the demand for investment slows, so will the demand for labor. There will be a waste of capital, for some investment projects will be scrapped, while others will be converted to uses less suitable than initially planned. Excess capacity will exist along with unemployed labor.

The inflation creates an artificial economic "high" by leading people to make investments that turn out to be unprofitable. In the absence of perfect foresight, there will, of course, always be unprofitable investments. What inflation does, however, is to increase the volume of such mistaken investments. As people subsequently come to revise downward their estimates of profitability and take corrective action, economic contraction will result. Such contraction is necessary as part of the process of correcting these previous mistakes, and this recession is implied by the previous inflation. The decision to have the inflation implies simultaneously a decision to have a subsequent recession, just as much as a decision to get drunk implies a subsequent decision to suffer a hangover. Without a continuing and accelerating inflation, the expansion in the producer goods industries will reverse itself, bringing forth recession.

What if the government attempts to counteract the recession by further money expansion? With a sufficiently

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strong creation of money, the recession can be postponed. But inflation cannot accelerate indefinitely, and contraction will result when the inflation slows. A dilemma results by attempting to resist the contraction, a resistance that may well be based on some inappropriate notion of a trade-off between inflation and recession. By increasing the amount of economic distortion, resistance increases both the amount of capital waste and the amount of concentration that is latent in the economy. Stagflation—rising prices alongside troublesome unemployment—is a natural outgrowth of attempting to resist or counteract by further money expansion the recession that was made necessary by the initial inflation.[4]

Inflation and recession are not options for choice, for a nation does not have the ability to choose a combination of the two at a particular time. Obviously, at any time there is both a rate of inflation and a rate of unemployment. But these two variables are not contemporaneously chosen and inversely related. Rather, they are directly related in a pattern of cause and effect. Unemployment today is a result of inflation yesterday, so to speak, and today's inflation will breed tomorrow's unemployment. The initial impact of inflation is to attract resources into employments that are generally less highly valued by consumers than the initial employments, the ultimate effect being the recession that is necessary to rectify this misallocation. A failure to accept the inexorability of this sequence, say by increasing the rate of money creation, results in stagflation, in which case economic sluggishness comes to exist along with inflation.

Inflation also increases errors in decision-making, both by persons and by businesses. Accounting systems, for instance, give more accurate information when prices are stable than when they are rising. While mistaken decisions will always occur because of our lack of omniscience, inflation will inject an additional source of error into such decisions. These mistakes must subsequently be rectified. Rectification, however, is a costly activity, one that reduces our real wealth. Additionally, inflation increases the real rate of taxation on corporations. This is due to the tax treatment of inventory and depreciation. Inflation increases the nominal value of a firm's inventory, which can thereby increase the "profits" that are subject to tax. Inflation also increases the price of replacing assets. With the nominal amount of depreciation limited to the purchase price of the asset, this means that only part of the opportunity cost of the asset is treated as a cost. The remainder is treated as "profit" and taxed. It has been estimated that the recent inflationary experience in the United States has increased the effective rate of tax on corporate profit from around 45 percent to around 70 percent. Such tax rates make future capital formation difficult, and this makes an increase in unemployment inevitable. These are further losses due to inflation, beyond those noted above.[5]

"The creation of government monopoly over money alters the constraints within which government conducts its activities, and alters them systematically by creating a bias toward monetary expansion."

What About Nonmonetary Sources of Recession?

Monetary disturbance is one source of recession, though it can occur in either of two ways: as an immediate consequence of monetary contraction or as a delayed consequence of inflation. However, inflation is not the only source of recession. There can be nonmonetary sources as well.[6] An economy is open to many such sources of disturbance, which if severe enough can result in recession. Sudden reductions in food production below anticipated amounts can bring on recession. So can oil embargoes or increases in oil prices, for these shrink the production possibilities open to an economy and disrupt the network of production relations. For instance, it was estimated that the 1973–74 oil embargo reduced employment by 500,000, and was responsible for a decline in Gross National Product of $10–20 billion in the first quarter of 1974.

But what is the role of policy in these instances? Expansionary policies cannot offset these disturbances. They will not substitute for the food or oil that was lost; we cannot eat currency, and our cars will not run on government bonds. These losses are irretrievable, and nothing can be done to change this. Such policies cannot even smooth the transition to a new pattern of economic activity. Indeed, they will make this transition more difficult. This nonmonetary disturbance will necessitate a readjustment in the network of economic relations, with changes in the pattern of prices being a means of facilitating this readjustment. Monetary expansion cannot assist this process of readjustment in prices. To the contrary, monetary expansion creates further, nonsustainable shifts in prices, which will make the process of economic readjustment a more difficult and costly one. Expansionary policies in response to such nonmonetary disturbances as shortages of oil or food cannot offset the loss in output, but can only complicate and disrupt the process of economic readjustment.

Economic Disorder as a Result of Politics

What about the third premise of postwar economic policy? If the tools of economic control are put to the best possible use, any contribution of policy to the creation of economic disorder will be a result of accident or error. There would be nothing systematic about the process of making economic policy that would bring on economic disorder. A growing number of analysts, however, have suggested that

there is a bias within the prevailing institutional order through which policy emerges that tends to produce economic disruption. This difference in perspective toward the policy process has perhaps been best summarized by Herschel Grossman in reviewing the contributions of James Tobin to macroeconomics. While Grossman's particular references were to Tobin, he was speaking of the dominant perspective in general when he noted:

> Tobin presumes that the historical record of monetary and fiscal policy involves a series of avoidable mistakes, rather than the predictable consequences of personal preferences and capabilities working through the existing constitutional process by which policy is formulated. Specifically, Tobin shows no interest in analysis of either the economically motivated behavior of private individuals in the political process or the behavior of the government agents who make and administer policy.[7]

There is strong basis for believing that the contrary view suggested by Grossman has much to contribute to an understanding of the sources of economic instability.[8] Economic policies can be used to gain political support. Generally, expansionary policies will increase political support because they will lead to increased incomes for some people. Similarly, contractionary policies will generally decrease political support because they will lead to reduced incomes for some people. Within our monetary system, which is now based wholly on government fiat, existing institutions can have an inflationary, and hence recessionary, bias. The repudiation of the gold convertibility of the dollar in 1971 was the last of a series of acts over a half-century that transformed our monetary system from a commodity to a fiduciary standard grounded in government monopoly. Consequently, the constraints on money creation were weakened. When a monetary system is based on a commodity like gold, an increase in the benefits promised to some people necessarily requires a decrease in the benefits promised to others, for there is no ability to create new money out of thin air. Government monopoly over a fiduciary standard, however, makes it possible to design a program to benefit some people without having either to curtail a program designed to benefit others or to increase taxes. The excess of desires to spend over the means to pay for such spending can now be bridged through money creation. The creation of government monopoly over money alters the constraints within which government conducts its activities, and alters them systematically by creating a bias toward monetary expansion.[9] As noted above, the resulting inflation will bring about recession and capital waste, so such economic disruption becomes a natural outcome of political conduct within a political environment in which government is large and money is produced by what is essentially a nationalized industry.

Relatedly, there is good basis for suggesting that economic policy will be biased by the proximity to an election, which also creates economic instability. This characteristic of economic policy has come to be referred to as the politi-

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INFLATION MONITOR

A regular feature of *Policy Report*, the "Inflation Monitor" reports on the effects of inflation as a monetary phenomenon and demonstrates its distorting influence on the structure of relative prices in the economy.

	PERCENTAGE CHANGE (ANNUAL RATE)			
	Latest 1 month	**Latest 3 months**	**Latest 6 months**	**Latest 12 months**
M-1	17.7	5.1	1.7	4.7
M-2	14.1	6.8	4.5	7.2
M-3	10.6	7.2	6.2	8.4
PRICE OF GOLD	–28.5	19.0	9.3	33.9
CPI-URBAN WAGE EARNERS	14.3	13.9	11.1	10.7
COMMODITIES, LESS FOOD	16.0	14.2	12.6	10.6
FOOD	10.9	15.7	14.3	12.3
SERVICES	12.3	12.1	9.1	9.9
FINISHED GOODS	13.8	11.5	14.9	10.3
CONSUMER GOODS, FOOD	–3.2	10.3	13.0	11.3
CONSUMER GOODS, NON-FOOD	16.5	13.5	12.7	10.3
CAPITAL EQUIPMENT	13.6	10.2	10.1	9.2
PRODUCER PRICES, BY STAGE OF PROCESSING				
COMMODITIES				
Crude materials, non-food	–6.6	17.6	18.5	18.3
Intermediate materials, less food	18.6	14.4	12.8	10.8
Capital equipment	13.6	10.2	10.1	9.2
Consumer finished goods, less food	16.5	13.5	12.7	10.3
FOOD				
Farm products	5.9	23.7	22.5	15.2
Consumer foods	–3.2	8.5	13.0	11.3

All figures are taken from the *Chartbook on Prices, Wages, and Productivity* (U.S. Department of Labor), *Monetary Trends* (Federal Reserve Bank of St. Louis), and the *Wall Street Journal*.

✓ Washington Update

✓ The Department of Education bill passed both the House and the Senate, yet it still may not become law. Amendments on busing, quotas, and abortion added in the House may jeopardize agreement on a final version of the bill. The House bill, which squeaked through by only four votes, survived a proposed amendment to change the name of the department to the Department of Public Education (DOPE). If enacted, the Department of Education will be the 13th cabinet department.

✓ The Moral Equivalent of War (MEOW) has resumed, and President Carter is relying heavily on the use of war rhetoric to carry the day for his energy proposals. The announced price tag for the Carter energy program is $142 billion, but many observers believe the estimate is conservative. The House rushed through a synthetic fuels bill, but the Senate has taken a more deliberate attitude and is holding extensive hearings on the issue. In present dollars, syncrude is expected to be about twice as expensive as OPEC crude, but in a war effort, who cares?

✓ Busing became a big issue on Capitol Hill in late July, when the necessary 218 signatures on a discharge petition made it possible to bring a proposed constitutional amendment to the House floor. It is unlikely that it will pass the Congress: A two-thirds vote is needed. Some antibusing members thought that the language of the amendment was potentially dangerous: It seemed to enshrine the idea of compulsory school attendance in the Constitution for the first time, and to give the Congress sweeping powers to "insure equal educational opportunities for all students."

✓ Communist China is interested in acquiring some American food, in return for some Chinese oil. Most-favored-nation status for China (and the loans, grants, and loan guarantees that go with it) is likely to be debated this fall, and the Administration is expected to urge the extension of MFN status to the Soviet Union as well. It may also decide to reconsider its policy of embargoing trade with Zimbabwe-Rhodesia.

✓ Government-controlled offshore contains an estimated 65 percent of our domestic petroleum supplies, but only 2 percent of the offshore has been leased. Two departments, Energy and Interior, have been squabbling about jurisdiction over the offshore, and there is no end in sight. Meanwhile, the leasing program continues to be delayed.

✓ The House may make some major changes in its internal organization: banning proxy voting, placing a limit on the number of committee employees, and realigning committee jurisdictions. Those are some of the recommendations of task forces set up by the Committee on Committees.

✓ Registration and the draft continue to haunt Congress. A defense procurement bill, which would mandate resumption of registration in 1981, has met stiff opposition in the House, and floor consideration of it has been delayed.

✓ Piecemeal economic planning, already in effect through the Economic Development Administration, will get a major shot in the arm if H.R. 4100 becomes law. The House and Senate Public Works Committees and Banking Committees have been marking up the bill. It would, among other things, provide grants to local governments to buy part ownership in private businesses and to impose economic development plans for their areas.

✓ The first major action in the energy war was a request from the commander in chief that his senior staff resign. The move was interpreted in the financial markets in Europe as a sign that the American government was not responding to the energy situation in a fiscally responsible manner; the price of gold was driven up to more than $300 per ounce, and the dollar was brought under increasing attack. While the public reaction to the President's war seems to be mixed, the reaction in Congress was generally negative. Even the Democrats have been caustic about the chaos at 1600 Pennsylvania Avenue and the game of musical chairs played with the cabinet officers. The crisis of confidence perceived by the President is real, but it is a crisis of confidence in his presidency, not in the nation.

✓ A 60 percent windfall profits tax is in the works, and efforts will be made on the House floor to attach an individual income tax cut and social security tax freeze to it. A business tax cut seems also to be approaching; it would achieve a cut primarily by accelerating depreciation of assets. The balanced budget has temporarily faded from view.

✓ The Senate has already passed a standby gasoline rationing program, and the House will probably follow suit. The House defeated a proposed rationing plan on May 10. The new legislation permits the President to design his own plan and eliminates the present requirement that Congress approve it. Congress would still retain the power to veto implementation of any plan devised by the President.

✓ SALT II is in trouble in the Senate, and legislation implementing the Panama Canal Treaties must be acted upon before October 1, when the transfer of property agreed to in the treaties goes into effect.

✓ Gun control is back. Senator Kennedy wants to ban the manufacture and sale of "Saturday night specials" and to pass a federal law similar to the Massachusetts statute that imposes a mandatory one-year prison sentence on anyone convicted of possessing a firearm without the proper license.

✓ While proposing massive new government energy programs, the President quietly decontrolled production of heavy crude and urged that profits derived from its production be exempted from any windfall profits tax.

Macroeconomic Policy (Cont. from p. 5)

cal business cycle.[10] By concentrating expansionary policies before an election, the incumbent party may be able to strengthen its electoral prospects. Expansionary policies will tend to be pursued relatively more vigorously before an election, with the pursuit of contractionary policies left to after an election. In contrast, a politically disinterested conduct of economic policy would take place without regard to the timing of elections. It is the state's monopoly over money that creates the potential for such a political business cycle. The combination of this monopoly with the pursuit of political self-interest can produce economic instability.

In the usual descriptions of macroeconomic policy, government is said to act as a balance wheel for stabilizing an otherwise unstable economy. Recognition that public policy emerges from a political process has rarely been incorporated into macroeconomic analysis, and such an effort at incorporation leads to a realization that political activity may actually create or intensify economic instability and disorder. State monopoly over money, as created by the Federal Reserve Act and strengthened over the past half-century, was not supposed to contribute to economic instability, but a growing body of literature suggests that it has and explains why it has had this effect. The pursuit of political gain in conjunction with an institutional setting of state monopoly over money contributes to economic instability, both through a general inflationary bias and through a particular bias due to the challenges of reelection. Both of these biases also promote recession and capital waste. Our existing institutional arrangements regarding money introduce politically related sources of instability into our economic life. Politicians can certainly not be expected to stop being politicians. They will continue to promote policies and seek reelection. What can be altered, however, is the nature of our monetary institutions. Various steps can be taken to remove money from the category of a nationalized industry, thus limiting the role played by the ordinary vicissitudes of politics in promoting economic disorder.[11] ■

FOOTNOTES

[1]A. W. Phillips, "The Relation Between Unemployment and the Rate of Change in Money Wage Rates in the United Kingdom, 1869–1957," *Economica* 25 (November 1958): 283–99. A survey of different perspectives toward the Phillips curve is presented in Thomas M. Humphrey, "Changing Views of the Phillips Curve," *Federal Reserve Bank of Richmond, Monthly Review* 59 (July 1973): 2–13.

[2]The ability of monetary expansion to bring about shifts in the structure of prices is documented in Daniel R. Vining and Thomas C. Elwertowski, "The Relationship Between Relative Prices and the General Price Level," *American Economic Review* 66 (September 1976): 699–708.

[3]On this theme, see Friedrich A. Hayek, *Prices and Production*, 2d ed. (London: Routledge and Kegan Paul, 1935); and Ludwig von Mises, *The Theory of Money and Credit* (London: Jonathan Cape, 1934).

[4]On stagflation, see Gerald P. O'Driscoll, Jr., and Sudha R. Shenoy, "Inflation, Recession, and Stagflation," in *The Foundations of Modern Austrian Economics*, ed. Edwin G. Dolan (Kansas City: Sheed and Ward, 1976), pp. 185–211.

[5]For some treatments of these points, see George Terborgh, *Inflation and Profits* (New York: Machinery and Allied Products Institute, 1974); Norman B. Ture, "Capital Needs, Profits, and Inflation," *Tax Review* 36 (January 1975): 1–4; C. Lowell Harriss, "Tax Fundamentals for Economic Progress," *Tax Review* 36 (April 1975): 13–16; and David Meiselman, "More Inflation, More Unemployment," *Tax Review* 37 (January 1976): 1–4.

[6]For a general survey of these sources, see Gottfried Haberler, *Prosperity and Depression*, 3d ed. (London: George Allen and Unwin, 1958).

[7]Herschel I. Grossman, "Tobin on Macroeconomics: A Review Article," *Journal of Political Economy* 83 (August 1975): 845–46.

[8]For a more extensive consideration of this topic, see Richard E. Wagner, *Politics, Business Cycles, and Economic Disruption* (New York: Center for Libertarian Studies, forthcoming).

[9]For a development of this argument, see James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977).

[10]For a sample of this literature, see William D. Nordhaus, "The Political Business Cycle," *Review of Economic Studies* 42 (April 1975): 169–90; C. Duncan MacRae, "A Political Model of the Business Cycle," *Journal of Political Economy* 85 (April 1977: 239–63; Bruno S. Frey, "Theorie und Empirie Politischer Konjunkturzyklen," *Zeitschrift für Nationalökonomie* 36 (1976): 95–120; and Richard E. Wagner, "Economic Manipulation for Political Profit: Macroeconomic Consequences and Constitutional Implications," *Kyklos* 30 (1977): 395–410.

[11]For one consideration of the types of steps that could be taken, see Friedrich A. Hayek, *Denationalisation of Money* (London: Institute of Economic Affairs, 1976).

AMERICA'S GREAT DEPRESSION

by Murray N. Rothbard

A scholarly, well-researched examination of American economic history between 1921 and 1933, this volume represents the principal opposition to both Keynesian and monetarist analyses. Professor Rothbard evaluates the events of this period utilizing the Mises-Hayek ("Austrian") business cycle theory of central bank induced malinvestment, comparing it with more conventional approaches. This comprehensive work traces the Great Depression to the inflationary policies of the Federal Reserve System in the 1920s. In addition, Rothbard reveals how the further interventions of the Hoover Administration after 1929—increasing inflation, imposing tariffs, fixing wage rates, etc.—only served to deepen and prolong the depression. Rothbard's impressive work uncovers major deficiencies in previous studies and finds Austrian economic theory the most exacting explanation for business cycle phenomena.

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"But unlike pirates of old, the union members—in a contract dispute with the ferry company—allowed their victims to wear life jackets and wade safely ashore after dropping 32 feet into the water.

"The union said its action was justified because the ferry was being run as a 'pirate vessel' without a union contract."

—*San Francisco Chronicle*, July 9, 1979

Like letter-carrying?

"The U.S. Postal Service proposed new rules that would allow private companies to deliver letters proven to be 'extremely urgent.'

"The proposed rules, subject to public comment for 30 days, are based on the agency's view that the private-express statutes, which give the agency a monopoly over letter-carrying, shouldn't be used to restrict services the Postal Service can't provide."

—*Wall Street Journal*, July 10, 1979

The bureaucrats are all wet

"New York executives who congratulate themselves on ordering mineral water instead of martinis at lunch may soon be startled to notice seemingly incongruous bottle labels that warn against drinking too much of the supposedly healthful stuff. The labels are being seriously considered by health officials in Albany who, along with their peers in a half-dozen other state capitals, have decided that the Perriers of the world need regulating. Already, enforcement by regulatory pacesetter California of its own, new mineral water standards has led to a recall, widespread relabeling, and threatened prohibition of at least one brand. Following that lead, New York, New Jersey, Michigan, and Maine expect to issue their own regulations this year, and Pennsylvania plans stricter enforcement of existing rules."

—*Business Week*, June 11, 1979

The high cost of bankruptcy

"The ability of corporations to shut down a plant or a business in the U.S.—never seriously threatened before—is under attack. The sleeper issue of plant closings will awaken into a growing political threat early next month when Representative William D. Ford (D-Mich.) will introduce a bill backed by powerful unions calling for employers to give up to two years' notice before closing a plant and to compensate affected workers and communities for lost wages and revenues."

—*Business Week*, June 25, 1979

What excuse did the other 48 have?

"On August 2, 1971, the Senate was prepared to vote on whether or not Congress should underwrite a $250 million loan to Lockheed Aircraft, which was in deep trouble....Ordinarily, Sen. Lee Metcalf of Montana would have voted against the Lockheed loan, for he was a harsh critic of large corporations that milked the federal budget.

"As it happened, Metcalf walked out of his office, heading for the Senate, determined to vote against the bill. But, unfortunately, he was in a condition not unusual for him toward the end of his life; he was drunk. Mushy drunk. Sen. Alan Cranston of California, home of Lockheed, cornered Metcalf and plied him with the sorrowful prospect of 30,000 Lockheed workers thrown out of work and onto the breadline. By the time Cranston was through, Metcalf was practically blubbering. He switched to Lockheed, and the loan support passed: 49 to 48."

—Robert Sherrill, in *San Francisco Examiner*, July 2, 1979.

Even if they weren't?

"Correction of any weakness that may be found in the wing-pylon connection [of the DC-10] will not end the matter. After the DC-10 is cleared on this account, a lot of passengers will still be unwilling to fly them. So the FAA, which initially granted the airworthiness certificate, ought to renew the plane's clean bill of health. That means satisfying itself that the original design studies of the aircraft were adequate."

—*Business Week*, July 2, 1979

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