the purge of chicago economists

ALAN REYNOLD

Open season has been declared on Chicago economics in general and on Milton Friedman in particular. In recent months, attacks on Friedman have appeared in such generally respected periodicals as the Society for Individual Liberty's *INDIVIDUALIST* and the Foundation for Economic Education's *FREEMAN* [1].

SOLVING MONOPOLY BY DEFINITION

The most misleading attack on Dr. Friedman begins in a suspiciously round-about manner: Murray Rothbard attempts to associate Friedman with Henry Simons' unique affection for trust busting and with Irving Fisher's monetary theory.

Professor Friedman, according to Rothbard, "still retains the old Chicagoite theory: that in some way, the absurd, unreal and unfortunate world of 'perfect competition' (a world in which every firm is so minute that nothing it does can affect its demand and the price of its products) is better than the real, existing world of competition, which is dubbed 'imperfect.' " It is, of course, true that Chicago economists, like most economists, often utilize the notion of "given" price (pure or perfect competition) as a useful simplification. This device enables one to make generalizations, such as "an increase in demand generates an increase in supply," without getting bogged down in exceptions and qualifications (a monopolist may not increase supply, in this case, but only raise price).

Friedman is, however, quite explicit that "there is no such thing as 'pure' competition. Every producer has some effect, however tiny, on the price of the product he produces. The important issue for understanding and for policy is whether this effect is significant or can properly be neglected . . . "[2]. Similarly, George Stigler's paper on the history of the idea of perfect competition criticized "the austere nature of the rigorously defined concept" and suggested redefining competition to mean simply "absence of barriers to entry and exit"[3]. Both Stigler and Friedman stress government's role as the cause of monopoly.

Israel Kirzner, a colleague of Ludwig von Mises, claims Chicago economists have "no awareness of the dynamics of market structure," though his supporting argument shifts to questions of relative "emphasis" and "focus"—clearly a matter of opinion [4]. Contrary to Kirzner, the perfect competition model is not irrelevant, but rather complementary, to "the market process set in motion by disequilibrium conditions." This process is the means by which markets *tend* toward frequently changing market-clearing (equilibrium) prices and outputs, in response to varied conditions of demand or supply. Many excellent discussions of the dynamic nature of markets may be found in Alchian and Allen's Chicagoite text, *UNIVERSITY ECONOMICS.* For example, "By selective differential survival, growth, and imitation by competitors, the population of business firms converges toward the maximum-wealth output and price programs"[5].

Rothbard's remark that Chicagoites label dynamic competition as "imperfect" is difficult to understand in view of Chicago's devastating refutations of "monopolistic competition," "administered prices," and "increasing concentration"[6]. In this, as in the other matters discussed, there is little tangible difference between the Chicago and Misesist ideas of competition. This is not meant to deny that Rothbard's "real, existing world of competition" could stand some improvement, though Chicago economists do not agree with each other about the need for regulation or anti-trust[7]. Most lasting monopolies are supported in some way by government, but "short-run" collusion can be troublesome and there exist some local and raw material monopolies. Rothbard's unique idea (that since he can't "conceptually identify" a monopoly price it must not *exist*) is not shared by Mises. In cases such as I have mentioned, Mises agrees that "monopoly prices can be realized even in the absence of government policies aiming directly or indirectly at their establishment. It is necessary to realize that consumer sovereignty is not perfect . . . "[8].

WHO LIKES INCOME TAXES?

Next, Rothbard tells us that "Chicagoites prefer the income tax, because in their economic theory they follow the disastrous tradition of 'orthodox' Anglo-American economics in sharply separating the 'microeconomic' from the 'macroeconomic' spheres." Again, Friedman is apparently being judged by his very tenuous association with Henry Simons' 1938 classic on *PERSONAL INCOME TAXATION.*

The unsuspecting reader would never guess that Friedman wrote, in 1952, one of the first unorthodox articles refuting "The Alleged 'Proof' of the Superiority of an Income Tax," and pointed out that even a nonprogressive income tax distorts the allocation of resources, services, and goods[9]. *If* Friedman "prefers" the income tax, it is only in the "lesser of evils" sense in which Dr. Rothbard himself seems to prefer it. In *POWER AND MARKET,* Rothbard tells us, "there are few taxes indeed that will not be as bad as the income tax . . . Certainly, sales or excise taxation will not fill the bill"[10].

Rothbard's allegation of a "sharp separation" between explanations of relative and absolute money prices (micro and macroeconomics) is plausible when applied to the forty-year-old writings of Irving Fisher, but it is not true of any Chicago (or Austrian) economists. In fact, it was Don Patinkin's doctoral thesis at Chicago that rigorously exposed this invalid dichotomy in the pricing process[11]. Of course all economists, Rothbard included, treat specific subjects in separate chapters or volumes. Does such isolation of "macro" and "micro" imply that the authors don't realize that "any sort of tax has unfortunate and distortive effects on the entire economic system" or that inflation disrupts income distribution and saving decisions? Certainly not—the charge is chimerical.

DEFLATIONIST AMBIGUITY

Continuing with his nostalgic, indirect technique, Rothbard reminds us that "Irving Fisher wrote a famous article in 1923 . . . which set the model for Chicagoite 'purely monetary' theory of the business cycle. In this simplistic view, the business cycle is supposed to be merely a 'dance,' in other words an essentially random, and causally unconnected, series of ups and downs in the 'price level' . . . . Therefore, since *the free market gives rise to this random 'dance,'* the cure for the business cycle is for the government to take measures to stabilize the price level" (emphasis added).

Observe the subtle shift from a "dance" caused by the quantity of dollars to the implication that Fisher's dance is supposedly caused by "the free market." Rothbard's last sentence *should* read, "since the government gives rise to this random 'dance,' the cure for the business cycle is for the free market to take measures to stabilize the activities of the monetary authority."

Many volumes of elaborate analysis and research show that every serious inflation *or* depression throughout world history can be directly attributed to monetary disturbances[12]. Rothbard simply dismisses this as "simplistic" and "statistical mumbo-jumbo."

From August 1929 to March 1933, one fifth of U.S. banks closed and the supply of money declined by over one third[13]. Friedman, as Rothbard says, therefore "attributes the 1929 depression not to the preceding inflationary boom, but to the failure of the post-Strong Federal Reserve to inflate the money supply enough, before and during the depression . . . . this 'purely monetarist' approach is almost the reverse of the sound—as well as the truly free-market—Austrian view . . . . Thus, Milton Friedman is, purely and simply, a statist-inflationist."

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Certainly, a one-third *decline* in the money supply is not enough "inflation," and Rothbard's only proof of the "preceding boom" (sic) is the fact that "*wholesale prices were either* constant or actually falling during the 1920's . . . " *Friedman shows that* "the severity of each of the major contractions—1920-21, 1929-33, and 1937-38—is directly attributable to acts of commission and omission by the Reserve authorities and would not have occurred under earlier monetary and banking arrangements"[14]. Does this sound like a "statist" view of a "dancing" free market?

More significant is Rothbard's charge that Friedman is an "inflationist" for not wanting peoples' bank accounts to be wiped out and for saying that the money supply and prices should not have been forced down. Friedman is, says Rothbard, pursuing the "quixotic goal of a stable price level." Gary North adds this unclear clarification: "a stable price level requires, logically, stable conditions . . . " (but the "level" is simply an *average* of ups and downs!).

These remarks betray an imbalance in Misesist thought. Small increases in the money supply, or even government deficits alone, are incorrectly treated as an automatic cause of disastrous price increases. Falling prices, however, are always spoken of as either a natural outcome of rising productivity or as an inevitable adjustment to the imbalances of a preceding inflation. In other words, the ideal of a stable, general trend of prices (a price level) is implicitly accepted when discussing price *inflation.* But the idea that prices could trend *down,* for no reason except collapse of the banking system, and that this could cause unnecessary suffering is ignored or rejected.

It might be objected that Friedman nonetheless remains an "inflationist" for prescribing *a 3% annual increase in the* supply of money. Of course, *any* increase in the amount of money is *defined as* inflationary by the Misesists, but they silently shift to the conventional meaning of inflation (rising prices) when discussing its effects. Clearly, no ill effects follow from stable prices, since the quantity of money keeps pace with rising output and population. As Melchior Palyi put it, "Money creation is inflationary when the additional purchasing power has no counterpart in goods and services people want to buy"[15]. Ludwig von Mises tells us there is nothing wrong with a "comparatively slight and harmless inflation"[16]. On Rothbard's definition, we would have to call Palyi and Mises "inflationists."

THE BOOM THEORY IS A BUST

Another Misesist, Gary North, has recently published an article which complements Rothbard's critique. "Citizens will not face the possibility," says North, "that the depression of the 1930's is being repressed *through the expansion of the money* supply, an expansion which is now threatening to become exponential"[17]. This dubious thesis shows how tenaciously the Misesist clings to his master's dictum that "no kind of experience can ever force us to discard or modify *a priori* theorems"[18]. If the theorems are correctly deduced from "action axioms," which only a heretic would dare question, then the theorems are True, regardless of how their implications contradict the facts.

North's "repressed depression" implies that any period during which there was no appreciable expansion of the money supply would finally bring on the prophecized inevitable deflationary adjustments. Yet, there have been several noninflationary periods during the postwar era, none of which revived the Great Depression. From December of 1958 to December of 1960, for example, there was no increase whatsoever in the supply of money[19]. There has been nothing remotely approaching "exponential" (doubling or tripling) monetary growth in the entire postwar period, when real output more than doubled, while the money stock did not. But Mises taught that more money is inflation, inflation is a "boom," and booms must bust. Therefore, North and Rothbard patiently wait, like vultures, for the inevitable disaster.

The Mises business cycle theory is internally consistent and has a superficial appeal, even though the whole idea of a "business cycle" is an antiquated anticapitalist myth (booms and busts *aren't* cyclical and *aren't* caused by business). The Mises theory does not, however, show why an excess expansion can't be rectified gradually, why price stability should ever cause monetary collapse, or even why *small variations in* real savings shouldn't create the same over-all havoc that *is attributed to small changes* in "forced saving"[20]. In short, the Mises-Hayek theory *doesn't really show why* booms must bust. Crucial assertions, like those above, are simply treated as self-evident.

In policy matters, the most significant distinction between Chicago and "Austrian" monetary theorists is that the Chicagoites prefer price stability (partly because people don't adjust easily to wage cuts) and the Austrians apparently favor deflation. This is curious, because most of Rothbard's arguments against inflation are reversible: unexpected variations in prices, whether up or down, cause mistakes, wealth transfers, disappointments and confusion. General deflation is not more necessary to adjust to particular errors of the boom than over-all *inflation is* necessary to cure specific unemployment problems. What *is essential to rational* calculation is predictable behavior of the monetary base.

The Austrian affection for a nice, "healthy" depression is unwarranted and dangerous.

RULES VERSUS CHAOS

Milton Friedman set out to make genuine (not just hypothetical) improvements on the existing phoney "gold backing" and fully discretionary central bank authority. A true gold standard is rejected as unfeasible, because gold has lost its aura of inviolability and because the historic performance of gold standards has been poor—due to inevitable introduction of uncontrolled fiduciary elements (bank notes, deposits, government notes, etc.). Moreover, many productive resources (about 1½% of national income) must be devoted to mining the money, and these resources could be used to produce something more wearable or edible.[21].

Gary North's rebuttal to the wastes of mining is that it is a bargain, since "free coinage restrains the capabilities of political authorities to redistribute wealth in the direction of the state." But political authorities have no obvious restraint on their far greater capabilities to use taxes for this purpose. Moreover, Friedman's 3% Rule achieves this restraint without mining costs and avoids the risk of wealth distribution from overly-free private coinage.

North assures us that money can be privately supplied: "A local bank could conceivably flood a local region with unbacked fiat currency. But these so-called wildcat banking operations . . . do not last very long." "Would there not be a chaos of competing coins, weights, and fineness of monies? Perhaps, for brief periods of time and in local semi-isolated regions. But the market has been able to produce light bulbs that fit into sockets throughout America . . . "

There is something a little unconvincing in all this. Just *how brief* are these brief periods of chaos and monetary floods? *How many* "local" banks and "local" regions (Los Angeles?) will be involved? How does the economy's ability to produce uniform light bulbs insure us against counterfeiting? Will I have to take all unfamiliar money that I'm offered to a jeweler or appraiser?

When the United States was last on a gold standard, from 1879 to 1913, "80-90% of the money stock consisted of silver, fiduciary currency, and bank deposits not matched by gold reserves"[22]. The period was marked by financial crises in 1884, 1890, 1893, and 1907. If this isn't what North and Rothbard have in mind, they should explain just how they'll prevent it and how we could possibly deflate prices enough to make the switch.

The existing system prohibits the use of gold as domestic money (which Friedman would not) and ties our base money to gold claims of foreign traders. The elastic "backing" of the currency by a small amount of untouchable gold in no way limits the most absurd imaginable increases in the money supply through either fractional-reserve loan creation or monetization of federal debt. The gold "backing" does, however, mean that a large gold drain to foreign claimants would compel an unjustified deflation or devaluation.

Artificially pegging the dollar in terms of gold leads to pegging the dollar in terms of foreign currencies. These arbitrary exchange rates often form a tariff-like barrier to international trade. Actually, the commodities purchasable with a reasonably stable American dollar are a more than adequate basis ("backing") for international, as well as domestic, trade. Gold should be completely free to seek its own trade ratios with currency and with other commodities.

Contrary to Rothbard, the Friedman rule to limit the discretionary power of the Federal Reserve needn't be mere "advice." Karl Brunner once suggested that, if necessary, it could be a constitutional amendment and violation could be a capital crime. Simpler legislation and a lesser sanction (say loss of employment) would probably suffice to keep Reserve authorities in line. It is, in brief, the existing chaotic system and the Misesist alternative which are characterized by "absolute fiat"—and not the Friedman plan. The choice is between rules and discretion—and chaos.

BEST OF PROBABLE WORLDS

We need men like Rothbard to set ideals toward which we can work; but we also need practical reformers, like Friedman, who actually put into effect a partial extension of market forces.

"From the point of view of a genuine libertarian," asserts Rothbard, "the more inefficient the State's operations, the better for freedom." Even aside from the gall of describing what viewpoint I must hold to qualify as a "genuine libertarian," this is a repulsive statement. It clearly involves self-sacrifice in the service of some abstract ideal. In what way will I be made more free by paying higher taxes for less goods and services? Is Rothbard pulling a dialectic and prophecizing that only a catastrophe will shrink the state?

I am not so concerned with my credentials as a libertarian as I am with my responsibilities as a father. For the forseeable future, the more inefficient the State's operations the less my children will be able to eat or wear, to play or learn. I see no objection to probable improvement by gradual steps. We are talking about real institutions and real people, not about all-or-nothing games of "King of The Mountain" and "Captain or I won't play."

ALL OR NOTHING

Examples of the kamikaze no-compromise approach can be found in any of the many recent objections to Friedman's policy suggestions. These critiques usually contain one or all of three common themes:

First, a proposed improvement is compared with some remote, highly unlikely ideal instead of being compared with the existing situation. The 3% monetary growth rule is judged inferior to a pure gold standard with 100% reserve banking. Negative income taxes, which, as Rothbard admits, "preserve half of the usual income incentive to work," are compared with the total abolition of public welfare rather than with current schemes in which all benefits are lost by working[23]. Improvements in equity and efficiency through adopting a proportional income tax are compared with no taxes at all. Next, we will probably hear that Friedman's efforts to abolish the draft are "statist" because we should abolish armies. When compared with Rothbardian heaven, any reformer becomes a devil.

The second line of attack involves solution by definition. We have already seen that 3% increases in the money supply are defined as inflationary, though larger increases in the gold supply would be perfectly "harmless." We also noted Rothbard's singular see-no-evil approach to monopolistic collusion. In the same vein, Rothbard feels that the notion of "neighborhood effects" is invalid because it is subject to abuse (the unpaid benefit of watching mini-skirts). To reject neighborhood effects, however, is to say that there are *no* benefits or costs that escape market pricing—a patently untenable position and one which is inconsistent with Rothbard's own argument that polluters should be liable for damages[24].

The third form that criticisms of Friedman often take is the attack of some perversion of the original proposal. In this way, George Pearson and Robert Patton were able to object to educational vouchers by predicting that vouchers will be combined with "extremely stringent controls"[25]. Henry Hazlitt used the same technique in objecting that the negative income tax will just be added to existing welfare rather than replacing any of it. Rothbard's pragmatic critique of the negative tax relies, in part, on the prediction that the "poverty level" will be set much higher than Friedman suggested[26]. These *are* important worries—not about the Friedman plans but about *unacceptable variations* on those plans. The original proposals would still constitute substantial improvement over existing arrangements.

CALLING A SPADE A GODDAMN SHOVEL

Rothbard proclaims: "It is hig. time to identify Milton Friedr for what he really is; it is high time to call a spade a spade, and a statist a statist." One problem with the "rigorou distinction" is that it deprives a lovely eipthet of significance. if Friedman is a statist, what do we call Galbraith or Marcuse? Friedman is, of course, what he claims to be—a "classical liberal"—an advocate of severely limited government, much like Ayn Rand.

"Mises' leading follower," according to Rothbard, is Friedrich Hayek. Yet Hayek advocates a monetary rule aiming at price stability and rejects the gold standard. Moreover, he uses the "neighborhood effects" argument, advocates educational vouchers, and accepts "a system of public relief which provides a uniform minimum for all instances of proved need"[27]. Surely Hayek, then, is qualified to join Rothbard's growing class of "statist inflationists," thus giving Friedman a famous Austrian for company.

But what would be achieved by such factious "ideological purity"? Allies and potential converts are banished, while real statists are shielded by being lumped together with prominent advocates of limited government.

Fortunately, the purge of Chicago economists from the libertarian movement is as ideologically unnecessary as it is tactically unwise. We have seen that many of the views which Rothbard ascribes to Friedman are not Friedman's. Sometimes the opinion is just inferred, as by untenable associations with some defunct economist, but other charges are quite explicit—and equally untenable. For example, Rothbard clearly says that Friedman (1) dubs real-world competition as imperfect; (2) believes the business cycle is a random dance of the unregulated market; and (3) doesn't want the government to return its stolen gold hoards to the people. Such allegations scream for verification: a page reference, a quotation—even out of context, just anything at all. But no references are forthcoming. Considering the impact of his attack, surely Rothbard's topic merits more precise treatment.

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Atlas shrugged at me

DENNIS J CHASE

On a recent flight to Boston to research a magazine article on Ayn Rand, I had a daydream: Miss Rand, who is to make her sole public speech of the year at the Ford Hall Forum, is deboarding her bus from New York. I am waiting for her at the bus terminal. With confidence (the dream continues), I belly my way up to her and say, "Miss Rand, I'm the writer from Chicago who was refused an interview with you, and I have some questions to ask." Stunned, Miss Rand smiles at my brashness and says yes, she would love to talk to me, and invites me to share her cab.

My questions are good, a fact Miss Rand recognizes, and we have a warm revealing discussion in which philosophical points are clarified and heretofore unreported tidbits of information are passed on for my exclusive use. Too quickly, we arrive at the hotel. I cannot thank her enough. As I step from the cab, I hear Miss Rand call to me sharply, **"Wait a minute! What about your share of the fare?"**

Of course, a pipe dream is always the delusion of a desperate man. Miss Rand has been my hero since I was 16 years old, when I read (but comprehended little of) *ATLAS SHRUGGED.* Eventually I devoured all of Miss Rand's novels: *THE FOUNTAINHEAD* (a nontechnical introduction to Miss Rand's philosophy of Objectivism); *ANTHEM* (a search for the word "I"); *WE THE LIVING* (her first novel); and three collections of essays—*FOR THE NEW INTELLECTUAL, THE VIRTUE OF SELFISHNESS,* and *CAPITALISM: THE UNKNOWN IDEAL.* I subscribed to *THE OBJECTIVIST,* the journal which she founded, contributes to, and edits; and I even came to an understanding of Objectivism, the tenets of which I can now recite: reality is an objective absolute; reason is man's means of perceiving it and his only means of survival; individual men should live for their own sakes; laissez faire capitalism is the only political-economic system that corresponds to man's nature.

In short, I was hooked. Still am. This trip represented the closest I might ever come to meeting the woman who so influenced my life. I thought of the experience of Nora Ephron, the free lance writer assigned by the *NEW YORK TIMES BOOK REVIEW* to analyze the appeal of *THE FOUNTAINHEAD*—then in its 25th year and 2.5 millionth copy. Refused an interview, Miss Ephron based the article on her schoolgirl disillusionment with *FOUNTAINHEAD* and subsequent rejection of Miss Rand's philosophy. In a trivial conclusion that has become standard for such pieces ("Objectivists occasionally smoke cigarettes with dollar signs on them" and "Miss Rand is said to wear a gold dollar-sign brooch" are examples), Miss Ephron writes:

> One would have liked to ask Miss Rand about that brooch, but she does not give interviews to non-sympathizers. One would have liked to ask a number of other questions: how she feels about *THE FOUNTAINHEAD's* continuing success, how she reacts when she thinks of the people in publishing who said it would never sell, what she does when she opens her royalty checks. Presumably, Ayn Rand laughs.

I tried a different tack—a number of them actually—and hoped that one would succeed. Miss Rand's only mailing address is 201 East 34th Street, headquarters of *THE OBJECTIVIST.* In a two-page letter to Miss Rand, I requested a personal interview, listed my qualifications, indicated my familiarity with Objectivism, and posited three lines of questioning I wished to pursue.

"Is your analysis of male/female roles at variance with some Objectivist principles," I wrote, "particularly your reference to 'woman *qua* woman' and your statement that 'the essence of femininity is hero-worship' in 'An Answer to Readers (About a Woman President),' from the December 1968 issue of *THE OBJECTIVIST?"*

(In an interview published in the March 1964 issue of *PLAYBOY* magazine, Miss Rand says: "I believe that women are human beings. What is proper for a man is proper for a woman. The basic principles are the same." In 1968, she wrote that no rational woman would want to be President.)

I continued, "I would like you to explain your concluding paragraph in your essay 'Apollo 11' (September 1969, *THE OBJECTIVIST)* which reads (in part):

> If the United States is to commit suicide, let it not be for the sake and support of the worst human elements, the parasites-on-principle, at home and abroad. Let it not be its only epitaph that it died paying its enemies for its own destruction. Let some of its lifeblood go to the support of achievement and the progress of science. The American flag on the moon—or on Mars, or on Jupiter—will, at least, be a worthy monument to what had once been a great country.

How does this jibe with your statement in the essay 'Collectivized Ethics' in *THE VIRTUE OF SELFISHNESS:*

> Science is a value only because it expands, enriches and protects man's life . . . A 'progress' extended into infinity, which brings no benefit to anyone, is a monstrous absurdity. And so is the 'conquest of space' by some men, when and if it is accomplished by expropriating the labor of other men who are left without means to acquire a pair of shoes.?"

Finally, "I would also like to question your endorsement of Richard Nixon for President and your seeming support for his administration . . . " On all answers, I promised a fair treatment and no hatchet job.

Miss Rand's answer—or rather her secretary's answer—was cryptic, no-nonsense, and standard:

Miss Rand has asked me to acknow-