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MURRAY ROTHBARD AND HIS CONTRIBUTION TO EXPLANATION OF AMERICA'S GREAT DEPRESSION

Bakalářská práce

Autor: Zdeněk Sejček

Vedoucí práce: Ing. Pavel Potužák

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Prohlašuji na svou čest, že jsem bakalářskou práci vypracoval samostatně a s použitím uvedené literatury.

Zdeněk Sejček

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1. Introduction

Firstly, in this thesis I will try to introduce Rothbard's approach to study of causes of Great Depression. Someone could drop a hint that we can find Rothbard's approach in his comprehensive "America's Great Depression", where he self summarized his arguments. But this work is not easy to understand: Rothbard as historian has included many of US historical details, names, less-known US government agencies etc. so reading through the whole book could be for non-experienced economist or even for student big challenge.

One of the main economics' challenges, since the first depression occurred, has been to explain causes and find forever-cure. Since the macroeconomics departed from classical economics, there have been many explanation theories around, and almost all have been using strict macro economic approach. It sounds logical; at first glance the depression seems to be out of microeconomic framework. It is neither concerned with one firm nor with one part of the market, but with all economic subjects on the market.

Suggest that there is a 2 x 2 matrix of economic approach on the first axis and with the cause and cure on another:

	micro economic	macro economic
cause		X
cure	X	

In this work, I will try to describe Murray Rothbard's explanation of Great Depression. I will confine myself only to USA, as Rothbard did, and the other world will be mentioned only if necessary. Some space I will dedicate to "Austrian Theory of the Trade Cycle" basics that Rothbard uses for his explanation and which is easily recognizable in Rothbard's methodology.

Next, Rothbard did not use graphs for illustration facts and I tried to summarize table data into colored graphs that illustrate Rothbard's numbers in more accessible form.

Next, Rothbard strictly do not use mathematical equations and, therefore, this thesis contains only few equations, mostly taken from neoclassical economics, and are used only in connection of comparison of various economic approaches.

Next, the Austrian approach is not homogenous, so final conclusions of other Austrian exponent may differ. I strictly tried to use only Rothbard's theory, with the exception of Austrian Business Theory Cycle chapter, where I used Rothbard's ancestor, Ludwig von Mises's theories.

It has to be mentioned that Rothbard often uses expression "inflation" as grow of money supply, even it has no influence on price level. In this thesis I will use it in the same meaning.

Finally, Rothbard's contribution to the Great Depression is not only by interpretation of historical statistics and facts, but also defense of Gold Standard, non-fractional bank reserves and responsible behavior of people influencing money and the whole banking system. This was not included in "America's Great Depression" so I tried to bring all these arguments together.

2. Tribute to Murray Rothbard

Mr. Libertarian, how Rothbard has been called, was educated scientist in such branches like economics, philosophy and history and author of more than 25 books and thousands of articles. His uncompromising approach to "pure economics" without any moral judgments and socialist's dreams leads to deeper understanding of "Human Action", especially compared to neoclassical economics that is using "homo economicus" as main subject of economic science. Where the "Austrian Economics" says "this is the way how human acts", Rothbard adds "so free them and let them act".

In addition to his whole-life struggle for libertarian's truth, the most comprehensive part of his work and one of the subjects of this bachelor thesis is Rothbard's contribution to theories of money and banking. In his papers or books, for all "Mystery of Banking" (1983), "What Has Government Done to Our Money?" (1963) and "The Case for a 100 Percent Gold Dollar" (1962), he advocates money as spontaneous product of human action and describes how, during 19th and 20th century, almost all states have stolen money and assigned money creation and money policy to themselves. It has since never been returned back to spontaneous powers of the market.

Especially, in his paper "The Case for a 100 Percent Gold Dollar" (1962), he assembled arguments why there is no way how to restore free market without 100 percent gold dollar. This, among other issues, will be discussed in this thesis.

Last but not least, in books called "Case against FED" and "The Origins of The Federal Reserve" he shows how, why and under which conditions FED has been created and in "America's Great Depression" (1963) how this historic mistake led almost all developed economies to Great Depression between 1929 and 1937.

It would be a mistake to forget his masterpiece "Man, Economy and State", post-Mises economics textbook. Where Mises and his "Human Action" ends and concludes Menger's era of Austrian Economics, Rothbard goes further and in one book introduces Austrian Economics and shows common mistakes of modern mainstream economics.

Rothbard's work also consists from various contributions to US History (especially to Banking History), History of Economic Thought, Libertarian Ethics etc.

3. Rothbard's contribution to Monetary Economics

1) Origins of Money

If we want to explain change of principle of money during "central banks revolution", we, at least, have to mention how money has occurred. In time of barter, all subjects of the market should find someone who had been searching for a good they had been offering, of course under time, wants and place coincidence[1], which was the most significant brake of the economic progress. Since the spontaneous birth of money, universal good respected by others as a mean of payment, these barriers had fallen and the unprecedented boom appeared. In this time, no governmental agency existed and until creation of central banking system, there was no reason to doubt that money was a product of spontaneous order.

It is to be mentioned that nobody made up from which material should money be created and in which units it should be measured, Rothbard describes[2] that for a long time weight units had been used as money units. The explanation is easy: because of spontaneously originated money without creating new unit, using ordinary one. How we will see further, fixed relation between weight unit and money unit protects money against official counterfeiting. When you ask yourself, what does one pound of gold mean, you will imagine one pound-size gold brick or big gold coin, but when you ask yourself how does one dollar of gold look like, the answer is not easy. The unfixed relation between weight and name of the currency is necessary condition to inflationary monetary policy. And when we imagine, that money is only governmental guaranteed paper, we cannot be surprised by what has happened to money since the beginning of the 20th century. But there's more, if we imagine what impact it has had to international trade – the world of only one currency (or more weight units, but with fixed relations) is the dream of all businessmen and travelers. Therefore, there will be no problems with disequilibrium in the balance of payments between two different countries.

2) Money supply – what is an optimal supply of money?

I have never had a chance to ask Rothbard this question, but after all, he would perhaps react irritable. Why? Because this answer to this question does not belong to economists at all! Rothbard's position is radical and uncompromising. In a market, e.g. fruit market, nobody knows how many apples should be grown and sold, and in free market economy, nobody has a right to force others to accept any amount to be the "needed" or "right" one. But, can we apply the same rule to money and currency? Rothbard

[1] For simplicity, we abstract from *indivisibility* mentioned in Rothbard(1983)

[2] Rothbard(1983), p. 10

answers yes. He followed Ludwig von Mises's position that "any supply of money will be equally optimal with any other"[3] So, the amount of money does not matter. But what does matter is a change in money supply. It changes relations among prices, and in connection with money supply increase, it depreciates debts and raises the price of loans. This property of any money supply's change is called „non-neutrality of money".[4] Therefore, where mainstream economics sees variables in equations, Austrian economists see also a structure.

3) Rothbard's defense of Gold Standard

Rothbard considered the Gold Standard to be a constant check regarding the governmental monetary policy. Supposing that we are under the Gold Standard and government want to inflate, it is able to do it for a while, but after a short time, government takes the risk of that "public might start getting worried and call upon government for redemption"[5]. The only way how to get out of this issue is to get more money in connection with taxes and to spend less money as governmental expenses. But as we know, the government wants to do exactly the opposite – to spend more and to tax less. Therefore, the abandonment of Gold Standard is the only way how to get "governmental hands" to be forever free, with no worry about future time and "ugly" redemption. Hence, during the 19th century, US government tried to persuade people not to use gold as an every-day currency[6], in spite of it all, people switched to the gold currency every time they recognized money inflation, so the advocates of the paper money understood that simultaneous use of gold money and paper money is impossible and, after all, tried to prohibit monetary use of gold. Since the beginning of the 20th century, gold use except for medical and numismatic purpose has been in US forbidden.

4) Role of the banks in inflationary process

Not an unimportant role in inflationary process has been played by banks since the fractional banking mechanism was enforced. The expression "bank" has many different meanings; Rothbard[7] himself shows the abysmal contrast between banking within a meaning of "loan banking" and the meaning of "deposit banking". The first type of banks receives deposits and pays interest for it and loan to debtors for a higher interest, so the difference between interests is their only income. They play no role in inflationary

[3] Rothbard(1983), p. 45
[4] Best described in Money and Credit by Mises (1913)
[5] Rothbard(1983) p. 54
[6] Several times mentioned by Rothbard
[7] Rothbard(1983), p.79 and p.87

process, they loan the same amount of money as they get from creditors, so no money has been added to general money supply. On the contrary, the deposit banks save the genuine money to the vault and print receipt that is instead used as gold. The bank's receipt is then saved to another bank and used to cover other deposits and so on hence the sum of the banks' assets and liabilities will grow. Total money in economy will increase and there is no reason role of those banks to be considered as neutral and non-inflationary. Rothbard often uses the expression "out of thin air" to name by this way new created money and adds sarcastic note that "it is the most important single thing to know about modern banking."[8]

5) US Treasury and deficits

The relation between government deficit and inflationary process depends on who will be the buyer of the government bonds. Suggest that private person buys a government bond at cost of $1000; this person should remove $1000 from its deposits and pay it to government, so after this transaction, total amount of money in the banking system will be the same. But suggest the situation when these bonds are bought by the central bank. Central bank will create new $1000 and will give them to the government and will receive governmental bonds at cost of $1000. But later, the government will spend this $1000 for governmental buys from private sector and these new created money will be saved to private banks[9] that will as soon as possible use this money to loan it to the clients, therefore, under the existence of multiplication effect, the total money in economy will increase by (suggest 10% reserve requirement) $10 000. The latter situation is the extreme one, because it is by law forbidden for central bank to buy governmental bonds directly, but using the private sector as a middleman, it is allowed. The inflationary effect of governmental deficits is evident.

[8] Rothbard (1983)

[9] To keep example simple, we don't reflect money balance in hand

4. Austrian Theory of the Trade Cycle

First roots of the theory can be found in last chapters of Ludwig von Mises' influential work „Theory of Money and Credit (1912)". It is not only act of courtesy to put in remembrance the fact that Mises inspired himself in work of Knut Wicksell (1898)[10] and that the first money related theory of depression was developed by Currency School in the first half of 19th century.

As theory says, the monetary system, in which bank institutions are permitted to create additional money overlapping their level assets, is extremely dangerous. The additional money lowers the rate of interest under its natural value and stimulates economic activity. Investments which would not have been considered profitable are now invested by hoping entrepreneurs, the production of goods rises, greater demand raises general prices and wages too, and everything continues until the banks stop themselves expanding the money supply. After some time come the disillusionment and recession. The magnitude of the depression is only the matter of how long had been inflated and how much additional money had been added on money supply. Why is the monetary expansion so dangerous? The answer sounds as usual: the short-term effects are absolutely different from long-term ones.

So, why do business cycles and business fluctuations exist? They exist because of continual change of values, environment and human action. It is meaningless to want by all people not to change their tastes, to want not to change labor force for years, not to change natural resources and technologies and so on. We live our everyday lives and the changes are inseparable parts of it. So, why there are economic theories trying to freeze the world and study it under the magnifying glass? I hope that Murray Rothbard has never understood it, or more, never wanted to understand it.

So what exactly we should understand under the term "stabilization"? Using Rothbard's words, it means to force people do something else then they would have done, to force people build houses when they don't want to build them, to force people to eat beverages they don't want to eat and we can continue ad infinitum. Stabilization is another one, in a row with other "superior goals", that does not solve the problems, but deeper them.

Small fluctuations and cycles can be explained by everyday changes, but how we make clear the big quantity of business errors that occur in the same moment? This is the main purpose, by Rothbard, why we need cycle theory.

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[10] As Mises himself pointed out, the demolition of the theory that "amount of the business transactions is not independent of the behavior of the bank" was due to Wicksell in Interest and Prices (1898)

If there were no central forces ruling economic factors, there would be no "boom-bust" cycles. But in the situation, when we have central monetary policy, when we have federal governments that are allowed to spend money however they like, it is unpredictable which try to "help" market will cause the depression.

The major subject of Austrian Business Cycle Theory is money supply. It make sense, all economic subjects, e.g. entrepreneurs and families, are compelled to use the same legal tender[11]. If there were more media of exchange, the fluctuation of one would not strike other ones. But un-spontaneous change in money supply and in the interest rate can cause unforeseen complications for the market.

If it happens and depression occurs, the biggest problem is the same that has caused the depression – governments try to prevent or delay liquidation, to inflate further to prevent the deepening of depression, to keep wages and prices up and eventually, to stimulate consumption and hamper savings. But unfortunately, all these steps will only intensify depression. They can temporarily shift off the depression, but not forever.

[11] A payment, by law, cannot be refused in the settlement of the debt and has to be used as medium of taxation.

5. Monetary Policy prior to 1929 – Rothbard's Analysis

1) Introduction

Business cycles are natural part of standard capitalistic economy and it will be hard to find an era in human history without business cycles, which are caused mostly by permanent change of technology, change in human needs and environment. If we wanted to cure cycles forever, the best way how to do it would be to stop these changes. In static world, there will be no cycles more. But this unimaginable solution would be so expensive and unfeasible, that even the socialist don't try to realize it.

In the past two centuries, the nature of business cycle has changed beyond the recognition. Main causes, natural changes, are now overshadowed by changes in aggregate components of economy, e.g. money supply and government spending. Earlier, the market lacked the concentrated power which should have changed whole aggregates and dramatically send whole economy in the grips of inflation. As Rothbard pointed out, small errors in each entrepreneur expectation and action balance each other and the sum of these errors should not have caused noticeable cycle violation. But since, things have changed. By creating governmental agencies equipped by unlimited power, each decision to solve problem can cause measureless changes in aggregate demand and supply and finally end by economic depression. And this is exactly what had happened to US economy since the beginning of 20th century and what brought the strongest and most modern economy to the knees.

2) Federal Reserve Act

Since December 23 1913, US have had central bank called Federal Reserve System. The evolution of the FED had begun in the second half of 19th century and had been continuing through beginning of the 20th century and peaked after bank crises in 1907. After then, it was only matter of time to central bank being created. As Rothbard pointed out in "The Origins of the Federal Reserve", there were two main financial blocks, Morgan group and Rockefeller group. Both, in any case, fighting against each other, were inpatient for central bank creation. With their influential pressure and after winning of the "pro-central-bank-wing" in presidential elections in 1896, they had opened doors for silent, but certain shift to the centralized banking system, safely covered by official "pro-gold" orientation. After the Gold Standard Act in 1900, the way to banking reform was free. The last straw was the panic of 1907. As Rothbard pointed out, the banks, supported by government, "were allowed to suspend specie payments". After the "public opinion" consolidation, that banking system needs, for a next time, "lender of last resort" to safe banks in troubles, the financial elites put the Federal Reserve System through. All advocates of various

monetary interventions now could celebrate new created tool for money control that was prepared to enforce increasingly popularity of “stable price level policy”.

Let’s talk shortly about the role of business in FED creation. Between 1860 and 1900, US experienced economic growth like never before and due to this experienced fall of prices as well. Falling prices are natural and there is no reason not to let prices fall - but only from customer point of view. If you saw the same situation from the point of view of large and rich business groups, due to big competition, their incomes cut down, as well as their profits. They recognized, that using cartels, they could stop prevent prices from falling and hence let prices start to grow, as well as their profits. First attempt to collect all important business into cartels failed because of instability of cartels. As Rothbard pointed out[12], it had been proofed thousand times that cartels are not stable and it is only matter of time before they start to disintegrate. Main reason will always be the arrival of competitive companies that have seen great profit opportunities and will invest into special business branches, and using modern technologies, they will offer better services and goods, so, cartels’ profits will start to fall. And this, exactly, happened. Business groups, J.P.Morgan and Rockefeller, recognized that there is only one way how to prevent other companies and producers from entering the business out of their control: to let government to force cartel to all companies and over all branches. And this is, exactly, summarized reason, why these two business groups had been trying to enforce cartels, tariffs and for all, government regulations.[13]

The same happened to financial business. During so called “progressive era”, starting in 1900, these two groups had been playing important role in FED creation. After bank panic in 1907, government had created special commission and only one quest it had to done was to prepare arguments and special recommendations why and how to base third, in a row, US central bank, but this time forever. It is not surprising that many members of this “bankers’ commission” were Morgen’s and Rockeffeler’s people, after all, imposed by power and influence.

There are some other reasons left, for example, the growing state banks, not out of Wall Street, in other words out of Morgan’s and Rockefeller’s control, they started to control business far from New York and there was no power to control them by old financial groups. This decentralization was an “eyesore” for “pro-centralizing” financial business pooled in Wall Street from “out of mind”. Only governmental driven centralization of whole banking branch, in other words, creating central bank, was possible way.

[12] In his seminar on Money and Goverment, Rothbard(1984)
[13] Rothbard(1984)

3) International Central Banks Cooperation

Immediately after the World War I the FED began to cooperate with other European central banks. The embodiment of this fact was person of Benjamin Strong, Governor of the Federal Reserve Bank of New York. He cooperated with almost all European central banks, mostly with Bank of England, Bank of France and German Reichsbank. The narrowest cooperation was between FED and Bank of England and many of FED's actions had been taken because of this cooperation. For example, Bank of England was frightened of higher interest rates in the US, because of England's return to the gold standard. This should be taken as try to play "game with gold standard". Government should be submissive to the medium of exchange, not to use it as a tool to achieve objectives.

The birth of so called "gold-exchange program" is one child of US-England central banks cooperation. True gold standard was replaced during 1920s by exchange program – since, foreign central banks had been using dollar to cover their own currencies, and so monetary gold was only collected in US Federal Reserve banks. The same policy enforced Bank of England to other European countries and their currencies were covered by British pounds.

4) The Inflationary Factors

Rothbard's analysis of the Great Depression begins with enumeration of inflationary factors, that all had contributed to the uninterrupted inflation in between 1920 - 1929.

Every central bank has many tools how to manage and control money supply. The first and the strongest weapon are reserve requirements. There are three possible scenarios of increasing money supply by reserve requirements:

1. Lowering minimal reserve requirements under the current level, the difference between previous money supply and new money supply will be $\Delta M = M_B \frac{rd0 - rd1}{rd0rd1}$ where M is total money supply, M_b is money base and r_d is reserve requirement. Suggest that we have economy with \$100 000 monetary base, so under the 10 percent of reserve requirements the total money supply will be \$1 million. But when we lower reserve requirements, the total money supply will rise by $\frac{r_{d_1}}{r_{d_2}}$ where r_{d1} is old reserve requirement and r_{d2} is new reserve requirement, therefore after we change minimal reserve requirement from 10 to 5 percent, we will get twice bigger total money supply.

So we have shown that even small change in reserve requirements will bring disaster for economy.

2. Second possible scenario might be to increase total reserves. The difference between old money supply and new money supply will be then $\Delta M = \Delta MB \frac{1}{r_d}$ where $\Delta M$is money supply difference, ΔMB is reserve increase and r_d is reserve requirement. The impact of this change to money supply is smaller than in case of reserve requirement change.
3. The third scenario is independent on central bank. Such situation can occur when banks hold more than minimum legal requirement reserves. This scenario is not useful for explanation of money supply increase during 20s, because as Rothbard pointed out „we can safely dismiss any possibility that resources for the inflation came from using up previously excessive reserves“[14].

Back to scenario 1, requirement change for time deposits had big impact on total money supply, because the difference between time deposits reserve requirement, 3 percent, and demand deposits requirement, 10 percent, is evident. By moving client's deposits from demand deposits to time deposits banks should increase their loans and this is exactly what during 20s had happened. We can ask our self, why the banks had not done this shift before the beginning of 20s? The answer we can find in Federal Reserve Act that had permitted banks to pay interest on time deposits, which was before creating FED forbidden. FRA had introduced the difference between time deposits requirement and demand deposit requirement and after the First World War the banks were "invited" to shift deposits.

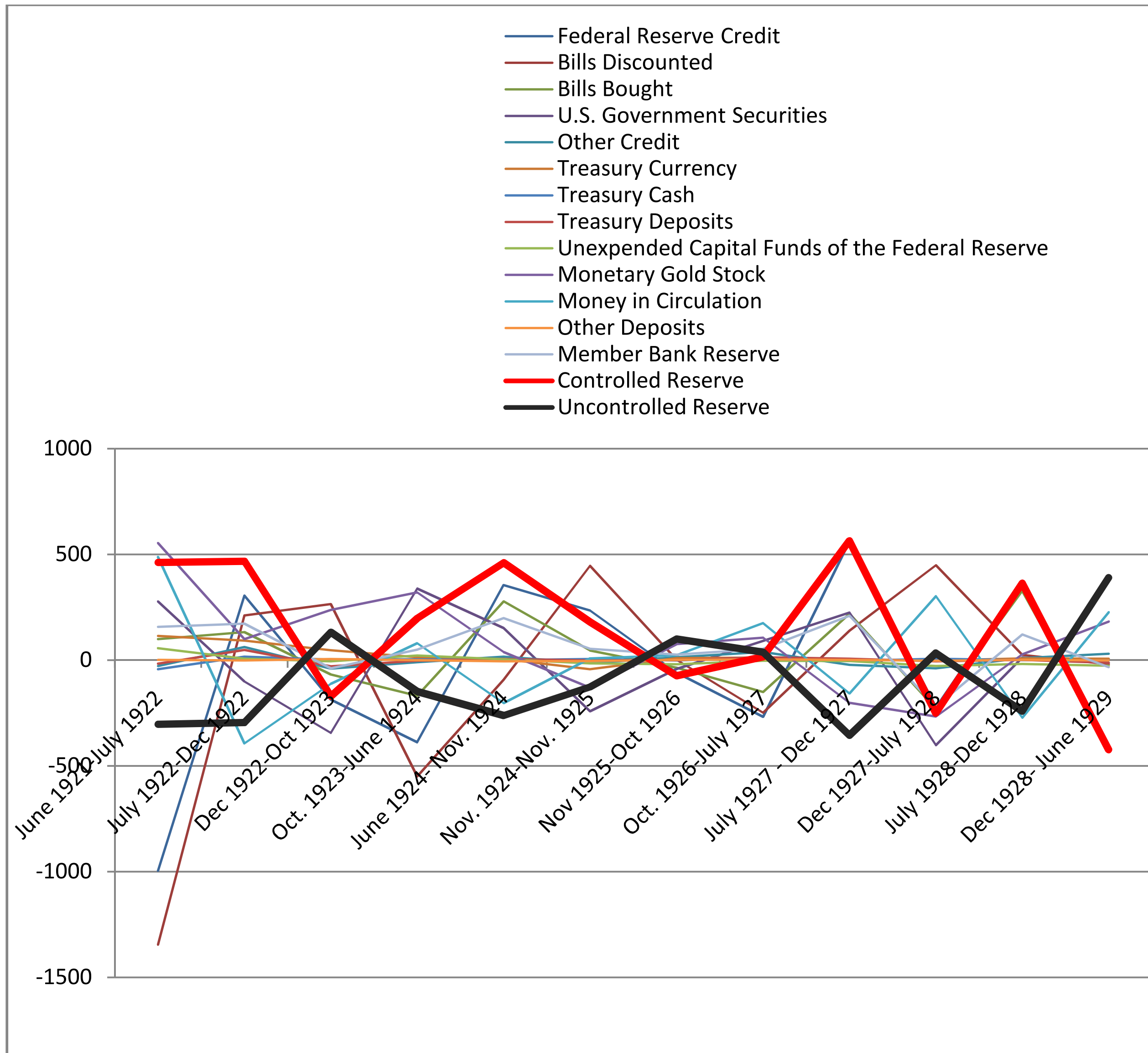
In the following graph I have illustrated movements in all inflationary factors collected by Rothbard. The main purpose of this is to show the progress of FED's monetary policy during 20s. I have highlighted the most important two factors: **controlled reserve** and **uncontrolled reserve**. The numbers are changes in relevant factors during twelve periods used by Rothbard. The first one (red line) is under full control of FED and is subject to FED's monetary policy, in other words, it is the tool how FED can react to changes in the second factor (black line), uncontrolled reserve. The total sums of changes in these two factors during 20s are in the following table:

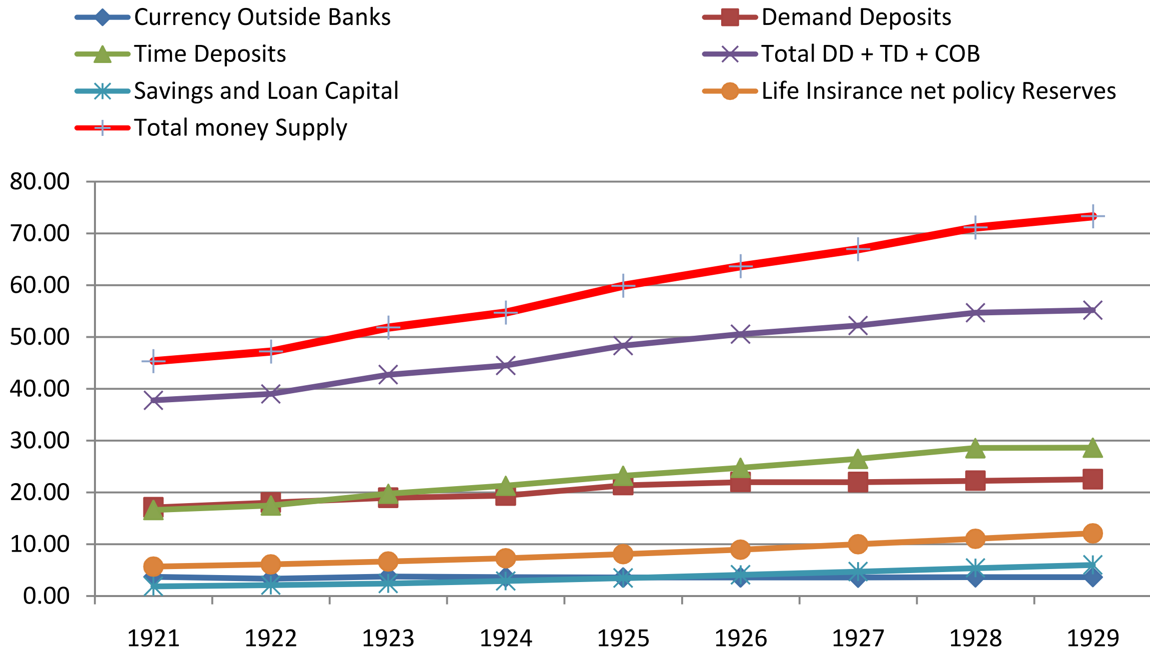
[14] Rothbard(2000), p. 96

TABLE 1

	June 1921 - June 1929
Controlled Reserve	$1794 millions
Uncontrolled Reserve	$-1040 millions
Total Increase	$754 millions

Sum of numbers during all 12 periods means increase of $754 millions.





So, from the first graph we can see how FED had been reacting to the changes in money supply by uncontrolled reserves and how, almost every time, FED had more than offset them. From the second graph we can see, how total money supply rose from the 1921 to 1929. Using Rothbard's methodology, and it means the use of broader measurement of the money including currency, demand and time deposits, savings-and-loan shares and the cash value of life-insurance policies, the money supply increased by 61.8%. We can compare Rothbard's methodology with Friedman's and Schwartz's[15] one, they used money definition known as M2[16] and their total increase was by 45%.

We can conclude that main condition of Austrian Business Cycle theory is fulfilled and the total money supply helped, with other factors, to cause Great Depression.

[15] Friedman and Schwartz (1963)
[16] Sum of currency in circulation, demand and time deposits

6. US government prior to 1929

1) Introduction

Rothbard has never separated the Federal Reserve System and US government and perceived them to be "one man". During the 1920s, FED and US government had been using the same theory and methodology of "stable price level theory" and they cooperated at maximum rate. At those times, only few economists had anticipated that tight cooperation of both sides can only lead to inflationary policy and that the lack of central bank independency would lead to such depression like in the end of 1920s.

Rothbard's main contribution on the US policy during 1920s has been the recognition that, often considered to be laissez-faire policy, had been pure socialistic and the last laissez-faire president of United States was Herbert Hoover.[17] This is absolutely untrue and Rothbard puts many evidences on why the presidency of Herbert Hoover had contributed to the Great Depression.

2) The Role of Herbert Hoover prior to 1929

For many historians, Herbert Hoover, 31st president of United States, was an opponent to Great Depressions' government policy, New Deal. During late 30th, he had been known as a one of the most influential critic of FDR's policy, overgrown government and state interventionism. But as Rothbard pointed out, it was just Hoover who, before and during his presidency, started new wave of governmental interference with traditional American laissez-faire economy[18]. It was not the first occurrence of government intervention in US history, Rothbard himself mentioned[19] years 1819 and 1921 as examples of violation of laissez-faire, but never in US history had the interventions been carried out with such a big verve.

Herbert Hoover (Secretary of Commerce since March 1921), contributed mostly with arranging various conferences, once on the labor-management relations (1919 - 1920), next time on unemployment (September 1921). Results of this conferences was mostly socialistic pressure of unions covered by government to enforce "child-labor abolition, old-age insurance, fewer working hours, better housing,

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[17] This fairy-tale is contained even in schoolbooks up to the present day.
[18] Herbert Hoover and The Myth of Laissez-faire, http://www.quebecoislibre.org/07/070916-4.htm, Rothbard(1972), published in A New History of Leviathan - Essays on the Rise of the American Corporate State, E. P. Dutton & Co., Inc. (New York)
[19] Rothbard(2000) s. 186

and health insurance".[20] Hoover himself used the term "voluntary cooperation"[21] to name this pressure. Rothbard himself titled Hoover "inflationist with the velvet glove on the mailed fist"[22].

Hoover's contribution to "laisser-faire" is larger; he was e.g. hard-core defender of public works during depressions and after he was elected as president of United States, he was prepared to start new "attack on poverty" using so called "Hoover's plan", the gigantic government plan to spend more than $3 billion to stabilize business cycle and iron out prices.

Hoover played un-substitutable role in cases against steel industry and later again railway industry. Regarding the "steel" case, the purpose of this public campaign was to reduce working hours in steel industry from 12-hour working day to 8-hour. As Rothbard pointed out[23], there were many strikes against shortening working hours in steel industry, not surprisingly held by employees, because it meant nothing else than cutting their incomes by one third. Regarding the "railway" case, the main purpose was to help unionization of railway labor relations. First attempt to control railways as a whole occurred during and immediately after World War I, when seized control over, but during 1921 railways were returned to private owners. The whole case ended in 1926 by issuing Railway Labor Act, which guaranteed collective bargaining to the labor unions.

The success of interventions had been very persuasive for other industries and simplified enforcement of other labor-related policies after "big crash".

Hoovers obvious and tight cooperation with labor-unions during 1920s had one and the most important aim: using growth of wages to gain prosperity and greater productivity. Hoover himself had been using term "new economics" to entitle socialistic policies. All these plans were brought off after "the Big Crash".

We should conclude this subchapter with Hoover's most famous quotation summarizing his time spent in White House:

[20] List of results is taken from Rothbard(2000), p. 189
[21] Rothbard(2000), p. 191
[22] Rothbard(2000), p. 188
[23] Rothbard(2000), p. 202

> "we might have done nothing. That would have been utter ruin. Instead we met the situation with proposals to private business and to Congress of the most gigantic program of economic defense and counterattack ever evolved in the history of the Republic. We put it into action…"[24]

Rothbard commented concluded Hoover's term in office with following words:

> "For the first time, laissez-faire was boldly thrown overboard and every governmental weapon thrown into the breach. America had awakened, and was now ready to use the State to the hilt, unhampered by the supposed shibboleths of laissez-faire."

3) Monetary imperialism

Standalone chapter in US monetary history is monetary imperialism. It may be mentioned, that this is not related to the Great Depression problem, but I have appended this chapter to show how government can use monetary unit to support its fight in colonial wars and to protect its gold against flowing abroad.

7. Great Depression – 1929 to 1933

1) Introduction

There is only one recipe, by Rothbard, for government to help its country and economy to get out from the depression: to let it "strictly alone"[25]. As Rothbard pointed out[26], the traditional policy in US, before 1929, was laissez-faire. As we said in previous chapter, Hoover's policy prior to 1929 cannot be considered being "non-interventional". In spite of that main purpose of this thesis is not to describe Great Depression, but show main reasons why Great Depression occurred, in this chapter I will shortly describe some important events and their implications.

Hoover's administration spent no time by waiting and Hoover himself called a series of White House conferences (November 18, November 21, November 22, and November 27) with various representatives of US industries, trying to persuade them to increase investments and extend production.

2) Government interventions between 1929 - 1930

To collect Rothbard's arguments, we will split government's interventions into following parts:

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[24] Rothbard(2000), p. 187
[25] Rothbard(2000), p. 185
[26] Rothbard(2000), p. 185

1. **Unemployment and labor market**: Following the trend popular in 1920s, the government interference into labor market had been intensified. "Voluntary" cooperation of government institutions and industry leaders should lead to stabilize wages. Hoover set the condition that wages could not fall more compared to cost of living that had previously fallen. Under the long-term inflation policy, it meant total freeze of wages in national leading industries (steel industry, railway, building and construction industry etc.) Hoover also tried to persuade labor unions not to press further wage increases, trying to wake up their "patriotism". In that time, labor unions were weak compared to our days, and they had no power to enforce higher wage rates. Even that Hoover's request could be considered being fight against labor unions, it helped them.
2. **Public works**: President Hoover, only one month after the crash, had begun with massive pro-public-works agitation. By sending letters to all governors (including Franklin D. Roosevelt of New York), asked them to help increase public spending according to public works. Shortly after Big Crash, the massive and all-society public-works agitation had arisen[27] and, previously in 1928 refused Employment Stabilization Act, got new chance and had been introduced with $150 million annual budget. The alternative plan, also introduced in 1930, was to protect US labor market against immigration lowering the wage rates. The numbers of immigrants, average 200 000 per annum, were decreased down to 70 000 in 1931. Rothbard compared this kind of "solution" to Hitler's restriction of women labor, "solving" the German unpleasant unemployment numbers.

3) 1931 - Critical Year

After two years of crises and depression, all had been waiting for recovery. But nothing changed. Since the beginning of the year, whole Europe was under the banking crises. Panic begun with fall of the biggest bank in Austria – Boden-Kredit Anstalt, merged with Oesterreichische-Kredit-Anstalt since 1929. After the redemption request from French banks, Austrian and German banks, being that time without liabilities, collapsed and promptly suffered under multiple runs. Austrian government soon abandoned gold standard, showing other countries disconsolate state of Austrian currency and declared state bankruptcy. Rothbard concluded[28] that it was due to American inflation as well as European inflation.

[27] See the list of economists in AGD p. 251 that had signed petition for public works expansion, including well known "stable price level economist" Irving Fisher.
[28] Rothbard(1983), p. 258

In the US, as Rothbard demonstrated[29], people confidence in US banking system had fallen in the first part of the year 1931. Main proof of this decrease should be increase of currency in circulation by over $300 million, in despite of the traditional money-in-circulation decrease after Christmas. So, as we know from previous chapters, the last thing that could help government to recover US economy from deepening depression was lost of legal tender and whole banking system confidence.

During this year, the wave of governmental interventions arose. The portion of federal government's spending on GNP rose from 16.4 to 21.5 percent[30] only during one year, and it was the biggest increase in so little time space in US history. The government tried even to interfere with US traditional relief organizations, but the biggest relief organization, Red Cross, refused governmental grant of $25 million with the argument that "its own fund was adequate".[31] In the following table, we can see amounts of dollars spent by voluntary and local state relief organizations:

TABLE 2

	Voluntary relief spendings
1929	$71 million
1930	$105 million
1931	$176 million

One of the most hazardous plans was Swope Plan[32] in September of 1931. In this well propagated plan, all industries were to be forced to join compulsory associations, known in that time from Italy fascism model. Here we can see one difference between Hoover and his successor, Franklin Delano Roosevelt – Hoover refused the plan, but only short time after, FDR enforced the same plan under the name NRA[33].

Despite the fact that Hoover refused to endorse Swope Plan, the spread of collectivist ideas in business world helped to enforce other collectivistic ideas in FRD era.

Rothbard did not dedicate much time to "Europe Great Depression", but we can conclude his explanation with his own words:

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[29] Rothbard(1983), p.261
[30] Lawrence W. Reed: Myths on Great Depression, Mackinac Center (2005)
[31] Rothbard(2000), p.271
[32] Named after Gerard Swope, head of General Electric
[33] National Recovery Administration enforced by FDR during 1933 and in 1935 ruled unconstitutional. But some parts of this plan survived in two subsequent bills

"Europe was hit hard partly in reaction to its own previous inflation, partly from inflation induced by our foreign loans and Federal Reserve encouragement and aid, and partly from the high American tariffs which prevented them from selling us goods to pay their debts."[34]

[34] Rothbard (2000), p. 257

8. Contribution of Economic Theory to Great Depression

In this chapter I would like to take up again the role of the economic theory prior to Great Depression. As Rothbard has outlined in Chapter 6 in his America's Great Depression, strong factor of Federal Reserve System and US government' (as well as other western governments') inclination to inflationary policy was due to evolution of stable price level theory.

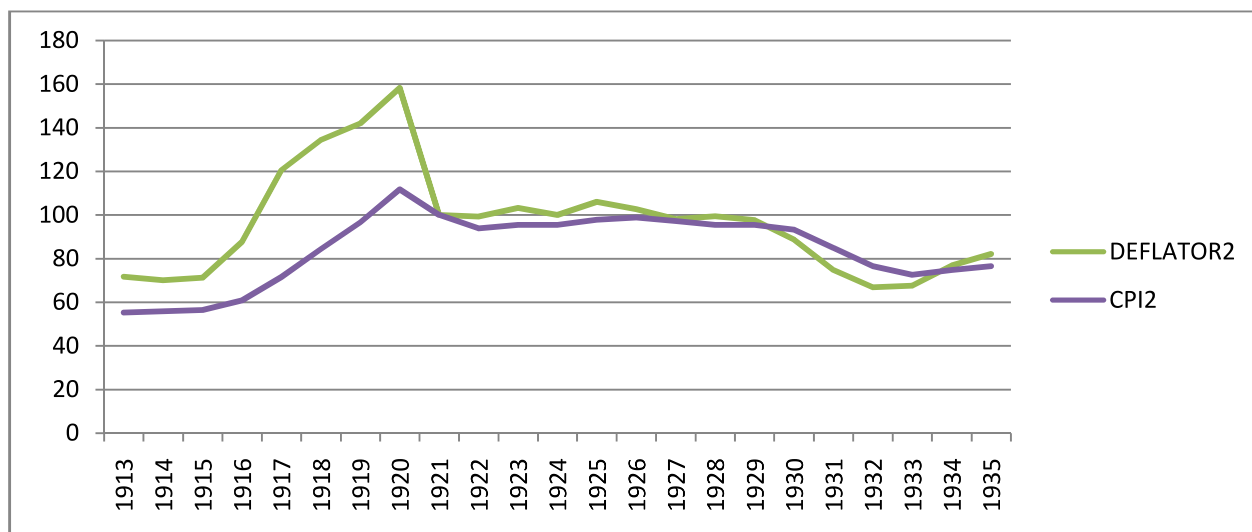
The main contributor to this theory in the first 30 years of 20th century was Irving Fisher. In his books[35], for all "Appreciation and Interest (1896)", "The Purchasing Power of Money (1911)", "Elementary Principles of Economics (1912)", "Stabilizing the Dollar (1920)" and "The Money Illusion (1928)" and in the many articles during 20s, he defended the stable price policy. To sum up his arguments, he dedicated his attention to relation between creditor and debtor and to the influence of price inflation and deflation regarding this relation. The inflation decreases real price of the same amount of money, because if you have $1000 today (supposing 10% inflation), next year you have the same amount of money, $1000, but you can buy less goods for it. So if you have lent to the friend $1000 for one year, you will get (supposing 10% interest rate) $1100, but the real value of the money will be the same as today, $1000, so you have lent to the friend under the condition of 10% increase of your credit, but you have got nothing more, the same real value after one year. Regarding the deflation, the routine will be the same, but the cost of the loan for your friend will be 20% of agreed amount of dollars.

So neither inflation nor deflation is benefit for economic relations and the main target of the monetary policy should be to stabilize money through the time. The concentration to this fact lured Fisher away from the other money consequences and did not recognized that this policy should have unforeseeable effects. Next graph shows price level during 1920 measured by CPI and deflator.[36]

[35] The list of Fisher's books is taken from Ebeling (1997)

[36] Numbers are taken from Consumer Price Index published by Bureau of Labor Statistics and from Historical Statistics of the United States – Colonial times to 1970

CPI AND DEFLATOR DURING 1920s



As we can see, the price level during 1920s had been almost stable, so we can conclude that the monetary policy held by US government and FED had been influenced by stable price level doctrine. As Rothbard pointed out, "stability was achieved only in consumer and wholesale prices" and the distortion of production structure "prevented the whole populace from enjoying the fruits of progress in lower prices." According to Rothbard, the wage raised for almost all industries, but for some by only 3% (meat packing industry), but for other by 25% (iron and steel industry). The difference between price increases cannot be covered by "boom in capital goods industry".

To be fair, we should notice that stable price theory was embraced in Europe, for all by Alfred Marshall and John Maynard Keynes.

Next, we have to bring in the significant difference between Keynesian approach, introduced retroactively by John Maynard Keynes in General Theory of Unemployment, Interest and Money in 1936, and Rothbard's "Austrian approach". While Keynes breaks aggregate demand into three components:

$$AD = C + I + G$$

Where AD is aggregate demand, C is private consumption, I is private investment and G government's purchases. To keep up aggregate demand, when, during depression, the C and I is under its potential and logically, AD has to fall, Keynes advises to increase government spending, therefore the AD will stay on the same or, alternatively, will even rise.

This is in contrast with Austrian approach. Austrian economics suggests that increase of G is always accompanied by government's tax income increase; therefore, before G can help to raise aggregate demand, it has to lower private consumption and private investment. Taking into account government's wasteful principle that the amount of tax revenues is lowered by bureaucracy expenses, senseless projects and disability of government to spend money purposeful (by reason of lack of information), there is no way how government can level up the aggregate demand.

In this short example, we can see that using "proper" economic theory every government can enforce almost everything, even disastrous and hazardous governmental planning, vindicated be one or more reasons, that can be seen, but somewhere, in the dark invisible parts of economy, can grow problems exceeding original solved problems.

Let's end this chapter with Rothbard's words:

> "We may conclude that the Federal Reserve authorities, in promulgating their inflationary policies, were motivated not only by the desire to help British inflation and to subsidize farmers, but were also guided—or rather misguided—by the fashionable economic theory of a stable price level as the goal of monetary manipulation."[37]

[37] Rothbard (2000), p. 181

9. Conclusion

Rothbard's contribution to the explanation of America's Great Depression is partly historical, partly economic and political. In all his books and papers, he advocates "true" lassez-faire social and economic system based on traditional American individualism. Rothbard's consistent approach, impeaching all possible economic, social and natural factors, leads to knowledge that taking over previously spontaneous order, clearly by government, would be first step to hell. This order, in our case monetary affairs, will be shortly substituted by imposed synthetic system, built on visible aims and tools. Previous natural order, with all its slim and invisible relations, aims and tools, originating for centuries, are in short time destroyed. For brief period of time, nothing could appear, but in long term, there is no escape from unforeseen consequences.

This, exactly, happened to US monetary system between ends of the 18th century and the Great Depression period. Combination of political force and conceit of economic theorists had severed natural money creation process and introduced "New Era" money, based not on gold or other valuable good, but on governmental needs. Dollar, in hands of in 1913 based Federal Reserve System, is since only governmental tool enabling gaining of "public interests", but no longer natural tool of trade.

There are many approaches by many different economic schools, and almost all of them have its own "Great Depression solution", but only Austrian School with Murray Rothbard and other "Austrians" have remained loyal to pre-FED monetary order. Other liberal movements, lead by Friedman's monetarism, accept post-FED monetary order, but only attach limitations, rules and theories. In this view, inflationary policy is acceptable and should be curbed only.

Rothbard tries to argue on behalf of Gold Standard, non-interventional public policy and voluntary market-based cooperation. Using this point of view, he finds most fundamental causes of Great Depression in:

1) Demolition of Gold Standard,
2) Takeover of money cooperation by Federal Reserve System,
3) Abolition of traditional US individualism and inclination of governmental exponents to collectivism and "voluntary cooperation",
4) Economic theory of stable price level policy,
5) Long-term inflationary monetary policy in 1920s,
6) and growing governmental interference with economic affairs

10. Attachments

Source table for graph on page 24.

TABLE 3

	DEFLATOR2	CPI2
1913	71.57057654	55.30726
1914	69.98011928	55.86592
1915	71.17296223	56.42458
1916	87.67395626	60.89385
1917	120.4771372	71.50838
1918	134.3936382	84.35754
1919	141.9483101	96.64804
1920	158.250497	111.7318
1921	100	100
1922	99.20477137	93.85475
1923	103.1809145	95.53073
1924	100	95.53073
1925	105.9642147	97.76536
1926	102.584493	98.88268
1927	98.01192843	97.2067
1928	99.40357853	95.53073
1929	97.61431412	95.53073
1930	88.66799205	93.29609
1931	74.75149105	84.9162
1932	66.79920477	76.53631
1933	67.5944334	72.6257
1934	76.73956262	74.86034
1935	82.10735586	76.53631

Source table for graph on page 16

TABLE 4

	June 1921-July 1922	July 1922-Dec 1922	Dec 1922-Oct 1923	Oct. 1923-June 1924	June 1924- Nov. 1924	Nov. 1924-Nov. 1925	Nov 1925-Oct 1926	Oct. 1926-July 1927	July 1927 - Dec 1927	Dec 1927-July 1928	July 1928-Dec 1928	Dec 1928- June 1929
Federal Reserve Credit	-996	305	-186	-388	355	235	-60	-268	562	-222	376	-409
Bills Discounted	-1345	212	266	-550	-92	446	2	-248	140	449	25	-19
Bills Bought	100	132	-67	-168	277	45	-36	-151	220	-230	327	-407
U.S. Government Securities	278	-101	-344	339	153	- 242	-41	91	225	-402	13	-12
Other Credit	-28	62	-40	-9	17	-14	14	39	-22	-39	10	30
Treasury Currency	115	93	47	14	5	-43	9	13	3	-2	8	7
Treasury Cash	-43	16	2	4	0	5	-2	13	-4	7	-1	-2
Treasury Deposits	-16	48	-29	-3	6	-2	0	14	7	-6	1	-13
Unexpended Capital Funds of the FR	56	6	-6	21	3	-15	-20	-3	-5	-28	-19	-26
Monetary Gold Stock	554	100	238	321	39	- 130	76	107	-201	-266	28	183
Money in Circulation	487	-393	-112	80	-203	8	23	175	-157	302	-272	227
Other Deposits	1	-2	6	0	-6	-4	1	4	2	-3	2	-1
Member Bank Reserve	157	173	-39	49	199	54	26	54	210	-220	122	-33
Controlled Reserve	462	468	-171	198	461	180	-74	16	564	-251	364	-423
Uncontrolled Reserve	-303	-295	132	-149	-262	- 126	10 0	38	-356	33	-242	390

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