The Free Market

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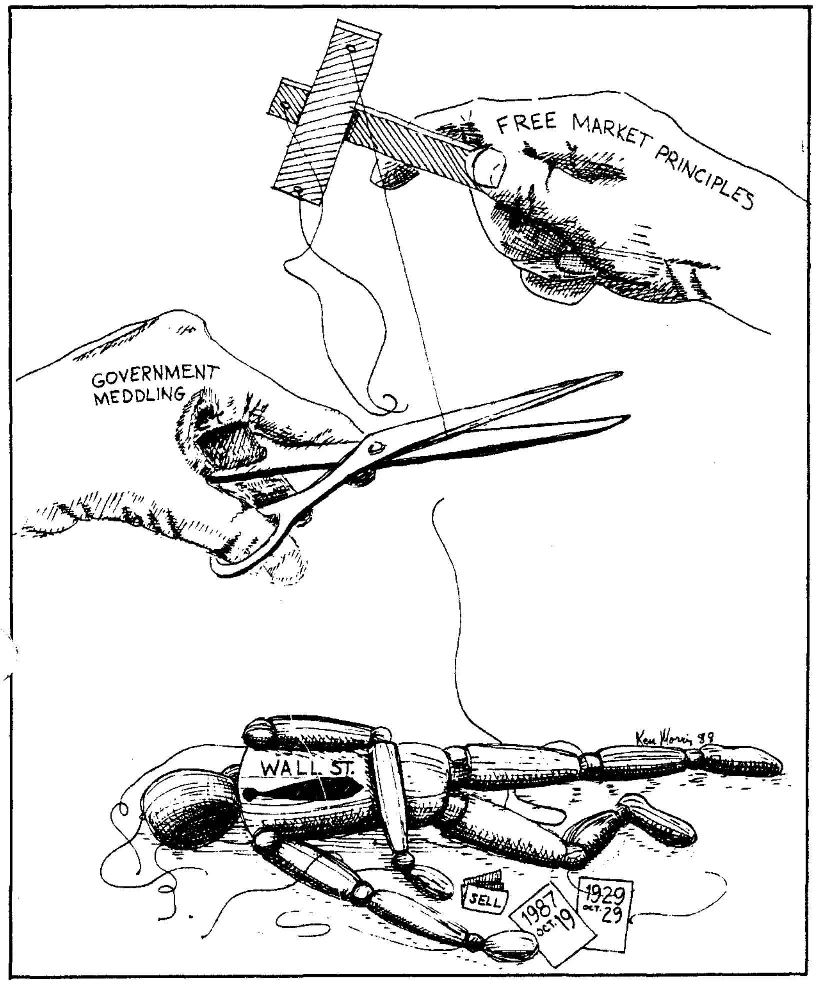

The Crash Commission Report

by Ron Paul

The crash of 1929, and the depression of the 1930s, entrenched the welfare-warfare state. Intellectuals, taking their cue from government propagandists, wrongly blamed the free market and the gold standard for the disaster. In a variation on the same theme, they are blaming the October 19th crash on insufficient government regulations.

Most prominent among the various stock market study commissions is the president's. But its recommendations are disappointing for anyone who values free markets. The stock market wasn't too impressed either. When the commission released its 340-page report, the Dow promptly fell 140 points.

The president's commission missed the true lessons of the crash—that Federal Reserve inflation causes the business cycle of booms and busts—and its recommendation for more regulation will only make matters worse.

The president had appointed Nicholas Brady, chairman of Dillon Read and an especially well-connected member of the Eastern Establishment, to head the commission. Also on it was John Opel, chairman of the New York Federal Reserve Bank, where the report was actually written.

"To help prevent a repetition of the events of mid-October and to provide an effective and coordinated response in the face of market disorder," said the report, "we recommend: one agency should coordinate the few, but critical, regulatory issues which have an impact across the related market segments and throughout the financial system; clearing systems should be unified across marketplaces to reduce financial risk; margins should be made consistent across marketplaces to control speculation and financial leverage;

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Chaos Theory: Destroying Mathematical Economics From Within?

by Murray N. Rothbard

The hottest new topic in mathematics, physics, and allied sciences is "chaos theory." It is radical in its implications, but no one can accuse its practitioners of being anti-mathematical, since its highly complex math, including advanced computer graphics, is on the cutting edge of mathematical theory. In a deep sense, chaos theory is a reaction against the effort, hype, and funding that have, for many decades, been poured into such fashionable topics as going ever deeper inside the nucleus of the atom, or ever further out in astronomical speculation. Chaos theory returns scientific focus,

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INSIDE

From the President

by *Llewellyn H. Rockwell, Jr.*

The *Real* Crime

One mark of government is its indifference to real crimes committed against people and property, and its hysterical reaction to crimes aimed at it. Government could care less, for example, about the daily terrorism of muggings, burglaries, rapes, and murders so typical of our large cities. But let one government employee be attacked overseas by political enemies, and the politicians go ga-ga, ready to spend any amount of our money and blood in return.

So it is within the borders of the U.S. A friend recently showed me two articles from the same newspaper. One reported on a 23-year-old money manager in New York who used $8 million of his clients' money to buy himself an art collection and a very high standard of living. He's now "cooperating fully" with the SEC and a court-appointed receiver, so the U.S. attorney has not yet decided whether to press criminal charges.

The feds know a real criminal when they see one, however, and they've sentenced a California man to two years in prison and fined him $100,000 for attempting to bring cheap Japanese computer chips into this country.

Congress and the president have made it illegal—and imposed these kinds of penalties—for entrepreneurs to try to supply American companies with low-priced Japanese chips. Why? As a subsidy to less-efficient U.S. chip makers and unions who have made liberal campaign and other donations.

Trade restrictions not only violate individual rights, they make us all poorer. Some U.S. companies which *use* computer chips in their products have had to lay employees off because of the higher cost and lesser supply caused by the new U.S. law. Others have lower profits. And consumers must pay higher prices—all to subsidize the government's unproductive friends.

Laws, quotas, tariffs, and agreements that hamper trade—domestic or international—serve the politicians and the special interests at the expense of the rest of us. Foreign prohibitions are usually dressed up in the language of patriotism. But they attack everything America really means.

In trade, as in so many other areas, if it bothers the government, it's probably good for us. ■

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at long last, to the real "microscopic" world with which we are all familiar.

It is fitting that chaos theory got its start in the humble but frustrating field of meteorology. Why does it seem impossible for all our hot-shot meteorologists, armed as they are with ever more efficient computers and ever greater masses of data, to predict the weather? Two decades ago, Edward Lorenz, a meteorologist at MIT stumbled onto chaos theory by making the discovery that ever so tiny changes in climate could bring about enormous and volatile changes in weather. Calling it the Butterfly Effect, he pointed out that if a butterfly flapped its wings in Brazil, it could well produce a tornado in Texas. Since then, the discovery that small, unpredictable causes could have dramatic and turbulent effects has been expanded into other, seemingly unconnected, realms of science.

The conclusion, for the weather and for many other aspects of the world, is that the weather, in principle, cannot be predicted successfully, no matter how much data is accumulated for our computers. This is not *really* "chaos" since the Butterfly Effect does have its own causal patterns, albeit very complex. (Many of these causal patterns follow what is known as "Feigenbaum's Number.") But even if these patterns become known, who in the world can predict the arrival of a flapping butterfly? The upshot of chaos theory *not* that the real world is chaotic or *in principle* unpredictable or undetermined, but that in practice much of it is unpredictable. And in particular that mathematical tools such as the calculus, which assumes smooth surfaces and infinitesimally small steps, is deeply flawed in dealing with much of the real world. (Thus, Benoit Mandelbroit's "fractals" indicate that smooth curves are inappropriate and misleading for modeling coastlines or geographic surfaces.)

Chaos theory is even more challenging when applied to human events such as the workings of the stock market. Here the chaos theorists have directly challenged orthodox neoclassical theory of the stock market, which assumes that the expectations of the market are "rational," that is, are omniscient about the future. If all stock or commodity market prices perfectly discount and incorporate perfect knowledge of the future, then the patterns of stock market prices must be purely accidental, meaningless, and random ("random walk"), since all the underlying basic knowledge is already known and incorporated into the price.

The absurdity of believing that the market is omniscient about the future, or that it has perfect knowledge of all "probability distributions" of the future, is matched by the equal folly of assuming that all happenings on the real stock market are "random," that is, that no one stock price is related to any other price, past or future. And yet a crucial

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Walter Block lectures at an Institute seminar.

The Case for a Free Market in Body Parts

by Walter Block

In days of yore, there was no "crisis" in spare body parts. Organ transplants were an utter impossibility, the stuff of science fiction. But nowadays, thanks to the magnificent discoveries and new techniques of modern medicine, it is possible to transplant hearts, livers, kidneys, corneas, and other organs. People who would have been consigned to death, or tenuous and painful lives only a few years ago, can today avail themselves of these medical miracles and lead healthy, productive lives.

However, instead of being the occasion for unrelieved rejoicing, these new breakthroughs have given us a whole host of new problems.

Most important, there is a shortage of body organs suitable for transplant, which has strained medical ethics to the breaking point. For, given the limited supply of donor-organs, our doctors have had to choose which of the many needy recipients shall have this life-giving aid and which shall not. And the doctors have no criteria upon which to base the choice other than their own arbitrary decision.

The difficulty is that our legal-economic system has not kept pace with medical technology. The law prohibits people from using the property rights we each have in our own persons. Specifically, it has banned trade, or a marketplace, in live spare body parts.

What, allow the profit incentive to work in this field? The very idea brings to mind images of grave robbers, Frankenstein monsters, and gangs of "organ thieves" stealing people's hearts, livers, and kidneys in Robin Cook novels.

But let's consider this idea on its own merits. Will a free market increase the number of donors, save lives, and free doctors from the need to pick which people shall be saved and which consigned to a lingering and painful death?

As any first-year student in economics can tell us, when there is a shortage of any good, the price is being held artificially low. And the case of spare body parts is no exception. In fact, the laws that prohibit a marketplace in human organs have effectively imposed a zero price on these items. At a zero price, we cannot be surprised that the demand for human organs has vastly outstripped the supply.

If the price of human organs were allowed to rise to its market level, barring new technological breakthroughs in artificial organs, there would still be a high demand from people needing an organ transplant to sustain their lives. Thus the immediate effect of a free market would be mainly on the amount supplied.

While it is never possible to fully know how an industry now prohibited by government edict would function, we can anticipate that the major sources would be young healthy people killed in car and other accidents and people who die from diseases such as heart attacks which leave their other organs undamaged.

If the organ industry were legalized, new firms would spring up, or perhaps insurance companies and hospitals would do the work. These companies or hospitals would offer thousands of dollars to people who met the appropriate medical criteria if they agreed that upon their death their organs would be owned by the firm in question. Then these firms would in turn sell these organs, for a profit, to people in need of a transplant.

In addition these new firms would, as at present, try to obtain consent from the relative of newly deceased persons for use of their organs. But only under a free market could these firms offer cash incentives for donors, not to mention the chance to save another life.

The effect of programs would be to vastly increase the supply of donor organs. No longer would potential recipients have to make do without transplants. And because the system is based on freedom, those who objected on religious or other grounds would not have to take part.

Nor need we fear that those who engaged in this business would earn "exorbitant" profits. For any such tendency would call forth new entrants into the market, increasing supply even further, and reducing profits to levels which could be earned elsewhere.

Liberty is the answer. If we want to save the American people pain, sorrow, suffering, and tragedy, we will work to institute a free market in body parts. ■

Dr. Block is senior fellow at the Ludwig von Mises Institute, co-editor of its Review of Austrian Economics, *and director of the Fraser Institute's Center for the Study of Religion and Economics.*

Don't Negotiate, Just Free the Market

Sheldon L. Richman

The agreement on trade negotiated late last year by the Reagan administration and Canadian Prime Minister Brian Mulroney has predictably polarized American opinion. There are more than two sides to the controversy, but unfortunately only two are being heard. One side, the protectionists, cries out that the agreement will let the Canadians take advantage of us. They will have access to the huge American consumer market, use subsidies to compete with American firms and workers, and generally prosper at our expense. The other side, loosely and misleadingly called "free traders" and led by President Reagan, says the agreement is the greatest thing imaginable, a historic blow for free trade.

Both sides are off the mark. The protectionists, of course, are just plain wrong. There is no harm in opening one's own market. In fact, if we are going to have trade agreements, an indication of their value lies in how much more easily they will allow American consumers to get foreign products. This is precisely the opposite of how the protectionists estimate their value.

But almost just as wrong as the protectionists are the supposed "free trade" forces rallying around the president. d they are wrong for reasons that are similar to those that apply to the protectionists. The salient question to them is this: if free trade is so good, why must we wait for agreements to be negotiated? Why not just open our markets and invite others to do the same?

The only reason for their failure to take the position implied in these questions is that they harbor protectionist premises, despite comments to the contrary. Here's a recent bit of evidence. In January Mr. Reagan made a speech in Cleveland in which he said that the U.S. trade deficit was a "sign of strength." Two days later the new trade statistics showed that the deficit had fallen 25 percent. Mr. Reagan pronounced this good news. Now if the deficit is in fact a sign of strength, why is its fall good news? Mr. Reagan was correct in Cleveland, but he did not know it. Why did he say it? Most likely because he did not expect the trade deficit to fall and he was preparing a defense.

What is the proper perspective on the Canadian-American trade agreement? Before I go into that, let me quickly describe it. The agreement would significantly reduce or eliminate barriers to trade in agriculture, investment, energy, and other products and services over ten years. It would eliminate all tariffs on U.S.-Canadian trade within ten rs, with some ending in five years and others immediately. anada's tariffs are higher than America's, but it should be noted that already some 70 percent of American exports enter Canada duty-free and 85 percent of Canada's exports enter the U.S. duty-free. Other non-tariff barriers, such as quotas, would also come off under the agreement.

But despite this, many of the more subtle barriers, such as regulations and subsidies, would be left in place. Moreover, American companies would still be able to ask the government for shelter from Canadian imports that "contribute importantly" to their "injury." This so-called Section 201 relief has nothing to do with "dumping," or other allegations of unfair conduct (which is not to concede that these are valid reasons for import restrictions). It relates instead purely to the effects of market competition. In other words, if a dynamic Canadian company "harms" an American industry by attracting consumers, the American businesses can run to the government for a duty or quota. One would think that a free-trade agreement would call for an end to Section 201 petitions, but unfortunately this is not the case.

The supposed free-trade agreement also leaves in place the Jones Act, under which only American ships may carry cargo between American ports. The American maritime interests were outraged at and forced the elimination of an early suggestion of change in the act with respect to Canadian ships.

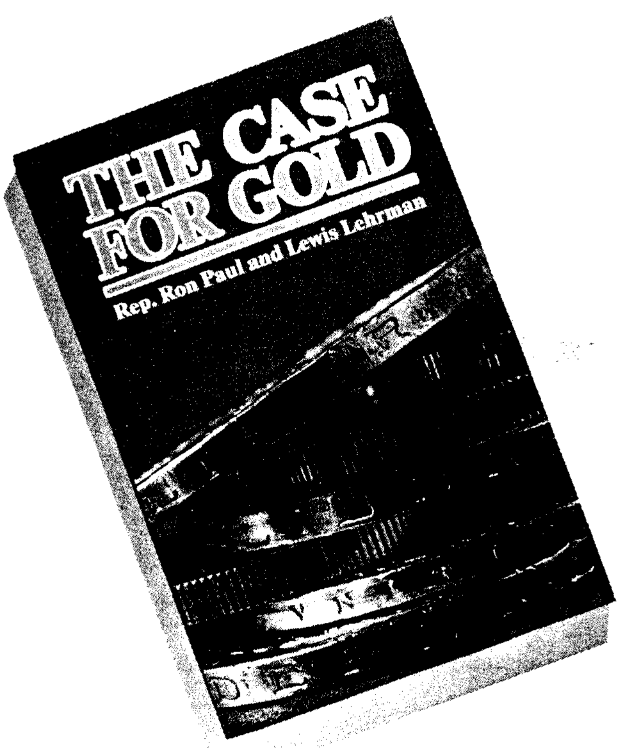
The agreement won't bring free trade in beer or sugar either. American beer is not included in the provision easing trade restrictions on other liquor exports because the United States would not exempt Canada from American sugar quotas. The U.S. government strictly limits sugar import from all countries in order to maintain a price-support system that keeps domestic sugar prices at several times the world price.

Not only does the agreement not allow for complete free trade between the parties, there are ominous signs that the United States and Canada together could become more protectionist toward the rest of the world. For example, under the agreement the North American auto market will become less open to cars made of Asian parts. A 1965 U.S.-Canada duty-free auto pact currently includes autos manufactured elsewhere, such as Japan and South Korea, but assembled in Canada. But the new agreement would impose a 50-percent North American "rule of origin" for autos built in plants constructed after the agreement takes effect. This is a blow to Japanese and Korean automakers, for whose products Americans show a distinct preference. Moreover, only current participants in the existing auto pact—namely, Chrysler, Ford, and General Motors—can receive its benefits, such as duty-free access to parts or vehicles from third countries. This is cartelization, an attack on free trade, and a slap at American consumers, who will have to pay more for cars not sold by the Big Three.

What should become of this agreement? As one can see, is a mixed bag. It does phase out tariffs and some, but not all, other barriers. On the other hand, it increases protectionism somewhat in at least one area. There is also something objectionable about "free trade" agreements per se: because they are the product of negotiation, they teach the wrong lesson about trade. Negotiation over trade necessarily implies that one opens one's own market only in return for an opening in the other country. But that is based on the mercantilist fallacy that imports unmatched by exports are bad. This in turn leads to all the nonsense about trade deficits being harmful, which they are not. This is why the great 19th-century free trader Richard Cobden denounced trade negotiations and called for unconditional, unilateral free trade for England.

Nonetheless, the agreement is on the table and its defeat would be a victory not for free trade but for protectionism. So it is best that it be approved in both countries. But it also means that free traders must redouble their efforts to instruct their fellows of the unmixed blessings of free international trade. ■

Sheldon L. Richman is director of public affairs of the Institute for Humane Studies at George Mason University and an adjunct scholar of the Ludwig von Mises Institute.



This brilliant exposition of the case for sound money is available from the Institute for $10, which includes U.S. postage and handling.

A Review of Ron Paul's *The Case for Gold*

by Jeffrey A. Tucker

The presidential campaign of 1980 brought free market ideas to the forefront of political debate. Those who believed in reducing the size of government knew that it wasn't enough to cut spending; the monetary regime that brought on 13 percent inflation and rollercoaster booms and busts had to be drastically reformed. The dollar had to be made inflation-proof, its value not subject to the irresponsible whims of politicians and central bankers.

It was those sentiments that led to the plank in the 1980 Republican platform calling for a gold standard, and Texas Congressman Ron Paul was leading the fight. Candidate Ronald Reagan talked about it too, until William Casey was appointed as Reagan's campaign manager and all mentions of gold ceased. We still heard less-government rhetoric, but without a call for a drastic change in the monetary regime, the free market agenda had been disemboweled.

Ron Paul had for many years worked in the House of Representatives for sound money. Thanks to grass roots support for the gold standard, his idea of a gold commission began to receive serious attention. And in 1981, the administration used the idea as a minor amendment to get conservative support for legislation pouring more billions down the International Monetary Fund rathole. Ron Paul voted against the entire package, but the bill passed, and a commission was appointed to study the role of gold in the monetary system.

Included among the appointments were Ron Paul and Lewis E. Lehrman, another leading gold standard spokesman. Opponents of gold dominated the rest of the commission, however, and the verdict was a foregone conclusion.

The forgettable majority report, written by Anna Schwartz and Michael Bordo for the Treasury, endorsed the present fiat paper money system and called the gold standard too constraining, expensive, and old-fashioned. The commission's majority did respond reluctantly to the public support for gold by agreeing to Ron Paul's idea of an American Eagle gold coin, today the most popular one in the world.

The minority report of the commission, however, became *The Case for Gold*, the most compelling and well-reasoned collection of arguments and evidence for the gold standard ever assembled in one volume.

In 1971 when Richard Nixon "closed the gold window" by breaking the U.S. treaty commitment to redeem the dollar for gold internationally, he also thereby removed all constraints on the Federal Reserve's ability to inflate and the government's ability to pile up endless debts.

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circuit breaker mechanisms (such as price limits and coordinated trading halts) should be formulated and implemented to protect the market system." Finally, "the Federal Reserve is well qualified to fill that role."

All markets *are* linked as never before, but the rules they want to impose will only "coordinate" the various sectors of American finance. This is a world market, as October 19th showed. Their own logic should compel the commission to call for unified world regulation of markets—an idea that delights world government advocates and that has already been suggested by people in the Securities and Exchange Commission.

Every one of the proposed regulations is, of course, bad, but one of the worst is the vague call for "circuit breaker mechanisms," namely "price limits and coordinated trading halts." This means the government would stop trading when things get "out of hand."

Raising barriers between willing buyers and sellers just makes markets less efficient, not to speak of violating the individual rights of would-be market participants. Plus price swings will inevitably be exaggerated once the market is opened again, as the case of the Hong Kong stock market showed when it was closed down for an entire week after the crash, and dropped even more precipitously later.

When government manipulates trading, it helps only the insiders (like Dillon Read investment bankers).

What was the fundamental cause of the October crash according to the Brady Commission? They don't know. And it's obvious that nobody on the Commission understands the business cycle. They illustrate their ignorance in appendix VIII of the report where they admit—20 years after Murray Rothbard's *America's Great Depression*—that they don't know what caused the 1929 Crash and the Great Depression. Of course, it was Federal Reserve intervention that caused it, and the Brady Commission wants more of the same.

Like Br'er Rabbit begging not to be thrown into the briar patch, the Fed responded to the Brady report by saying it wasn't sure it wanted more power. That's nonsense. They're salivating at the prospect.

If the new regulations are imposed, they won't, as the report claims, "ensure that our securities market will maintain its global preeminence." They will only ensure that the old financial Establishment will keep its influence in Washington.

Commissions like Brady's serve to reinforce the myth that the crash was caused by a mere technical maladjustment. Thus they conclude that we need a mere technical change. But the problem is more fundamental than that. The Federal Reserve—the dollars they create and the government they fuel—is the source of our problems. ■

Former Congressman Paul is distinguished counselor to the Ludwig von Mises Institute, publisher of the Ron Paul Investment Letter and Political Report *(1120 Nasa Boulevard, #104, Houston, Texas 77058, $99 a year), and 1988 presidential candidate of the Libertarian Party.*

Upcoming Institute Events

April 14-15, 1988: "Taxation: An Austrian View" conference in Washington, D.C.

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June 25-July 1, 1988: "Advanced Instructional Conference in Austrian Economics" at Stanford University, Palo Alto, California

August 13-19, 1988: "Introductory Instructional Conference in Austrian Economics" at Dartmouth College, Hanover, New Hampshire

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As the book shows, Nixon's action wasn't the first time the government reneged on its monetary promises. It all started with the issuance of fiat paper by the colonial government of Massachusetts in 1690, which resulted in high prices, business cycles, hoarding, and legal tender laws. And the pattern has been repeated many times. The book takes the reader through nearly 300 years of monetary history and shows that every time the government moved one more step in the direction of pure paper money, bad consequences followed.

Monetary economics was not always the monopoly of politicians and specialists that it is today. It was once a hotly and widely debated subject. The book shows that America's most fervent advocates of inflation were also connected with the banking industry, which would benefit from the inflation, and that they were proponents of big government in general. By contrast, the masses of voters have always favored hard money over inflation when given the choice. Too often, though, the people have not been given that choice. They have been coerced through fraudulent banking practices—onto which the government conferred legal status—and had the value of their monetary unit stolen away by a government afraid that direct taxation would prompt a revolt.

"Our historical experience," say the authors, "illustrates the overwhelmingly superior case for the gold standard as against any form of paper standard. There has never, in peacetime American history, been any sustained rate of inflation to match the inflation since 1941. The same, in fact, is true of wartime, which at least has never lasted more than a few years. And it is not an accident that the highest, most accelerated rate of inflation has taken place since 1971, when the United States went off the international aspects of the gold standard and went over completely to fiat paper."

The solution is not, however, to "return" to a gold standard. As Ron Paul says, "we can learn from the mistakes of the past, improve upon past systems, and go *forward* to a modern gold standard." And the authors give us a program for sound money: no Federal Reserve, no legal tender laws, no fraud, purely free banking, private coinage of gold and silver, and a dollar defined as a weight of gold.

This minority report of the U.S. Gold Commission put the idea of serious monetary reform back on the political map. If the country ever starts down the road to sound money, *The Case for Gold* will serve as a great guide. ■

Mr. Tucker is a graduate student at George Mason University, administrator of the Institute's Fertig Center, and managing editor of The Free Market.

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fact of human history is that all historical events are interconnected, that cause and effect patterns permeate human events, that very little is homogeneous, and that nothing is random.

With their enormous prestige, the chaos theorists have done important work in denouncing these assumptions, and in rebuking any attempt to abstract statistically from the actual concrete events of the real world. Thus, the chaos theorists are opposed to the common statistical technique of "smoothing out" the data by taking twelve-month moving averages of monthly data—whether of prices, production, or employment. In attempting to eliminate jagged "random elements" and separate them out from alleged underlying patterns, orthodox statisticians have been unwittingly getting rid of the very real-world data that need to be examined.

These are but a few of the subversive implications that chaos science offers for orthodox mathematical economics. For if rational expectations theory violates the real world, then so too does general equilibrium, the use of the calculus in assuming infinitesimally small steps, perfect knowledge, and all the rest of the elaborate neo-classical apparatus. The neo-classicals have for a long while employed their knowledge of math and their use of advanced mathematical techniques as a bludgeon to discredit Austrians; now come the most advanced mathematical theorists to replicate, unwittingly, some of the searching Austrian critiques of the unreality and distortions of orthodox neo-classical economics. In the current mathematical pecking order, fractals, non-linear thermodynamics, the Feigenbaum number, and all the rest rank far higher than the old-fashioned techniques of the neo-classicals.

This does not mean that all the philosophical claims for chaos theory must be swallowed whole—in particular, the assertions of some of the theorists that nature is undetermined, or even that atoms or molecules possess "free will." But Austrians can hail the chaos theorists in their invigorating assault on orthodox mathematical economics from within. ■

Dr. Murray N. Rothbard, whose undergraduate training at Columbia University was in mathematics, is vice president for academic affairs of the Ludwig von Mises Institute and S.J. Hall distinguished professor of economics at the University of Nevada, Las Vegas.

A Review of Murray N. Rothbard's "Microeconomics"

by Mark D. Hughes

"Microeconomics: An Austrian Viewpoint" by Murray N. Rothbard is a series of ten audio tapes produced by the Ludwig von Mises Institute with 15 hours of actual classroom lectures on microeconomic theory and application by Professor Rothbard at New York Polytechnic University in 1985. The Austrian perspective, combined with Rothbard's teaching ability, makes the principles of microeconomics interesting and understandable.

Beginning with an explanation of what the micro in microeconomics means, he continues by discussing human action, scarcity, subjective valuation, and uncertainty and risk, all cemented together with Crusoe economics, time preference, and means/ends analysis.

Rothbard also discusses demand and supply, consumer goods, prices and exchange, and gives an uncommonly clear explanation of product relationships. With unmistakable wit, he examines case studies of government interference in the market. Rothbard's stories of the energy crisis and the oil cartel, price controls in agriculture, licensing of New York taxis, the minimum wage, and other issues are riveting, and elicit outrage toward meddlesome government.

The real-life classroom setting bestows a charming atmosphere on the series, and a student listening often feels like leaning over and whispering to the fellow next to him, "Isn't this guy fantastic?" ■

Mr. Hughes is a graduate student at George Mason University and academic coordinator of the Institute's Fertig Center.

NOTE: This ten-tape set is available from the Institute for a bargain price of $70, which includes shipping and handling. Please see the enclosed form.

Quote of the Month

"The classical or orthodox gold standard alone is a truly effective check on the power of the government to inflate the currency. Without such a check all other constitutional safeguards can be rendered vain."

— Ludwig von Mises

The Theory of Money and Credit, p. 495

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