The Free Market

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Nine Myths About the Crash

by Murray N. Rothbard

Ever since Black, or Meltdown, Monday October 19th, the public has been deluged with irrelevant and contradictory explanations and advice from politicians, economists, financiers, and assorted pundits.

Let's try to sort out and rebut some of the nonsense about the nature, causes, and remedies for the crash.

Myth One

It was not a crash, but a "correction."

Rubbish. The market was in a virtual crash state since it started turning down sharply from its all-time peak at the end of August. Meltdown Monday simply put the seal on a contraction process that had gone on since early September.

Myth Two

The crash occurred because stock prices had been "overvalued," and now the overvaluation has been cured.

This adds a philosophical fallacy to Myth #1. To say that stock prices fell because they had been overvalued is equivalent to the age-old fallacy of "explaining" why opium puts people to sleep by saying that it "has dormitive power." A definition has been magically transmuted into a "cause." By definition, if stock prices fall, this means that they had been previously overvalued. So what? This "explanation" tells you nothing about why they were overvalued or whether or not they are "over" or "under" valued now, or what in the world is going to happen next.

Myth Three

The crash came about because of computer trading, which in association with stock index futures, has made the stock market more volatile. Therefore computer trading and/or stock index futures, should be restricted/outlawed.

This is a variant of the scapegoat term "computer error" employed to get "people errors" off the hook. It is also a variant of the old Luddite fallacy of blaming modern technology for human error and taking a crowbar to wreck the new machines. People trade, and people program computers. Empirically, moreover, the "tape" was hours behind the action on Black Monday, and so computers played a minimal role. Stock index futures are an excellent new way for investors to hedge against stock price changes, and should be welcomed instead of fastened on—by its competitors in the

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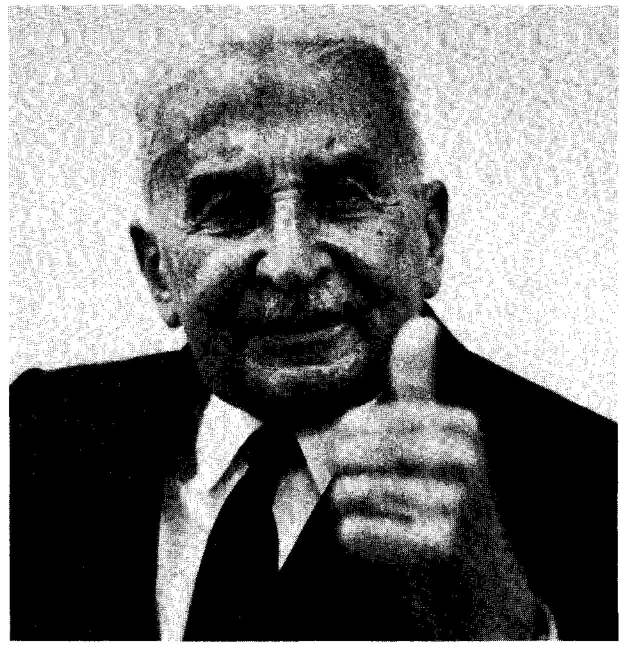

This expressive photo of Ludwig von Mises by David Jarrett is a favorite of our students. As one put it: "It shows exactly what he would think of the Institute's work."

How Our Economic Constitution Has Deteriorated

by Robert Higgs

Many people think of the Constitution as essentially unchanged, yet today's document bears little resemblance to the original of 1787 in its relation to the economy. The original words remain, but they have been formally amended in critical ways; and reinterpreted by the Supreme Court so that their practical effect has become almost the opposite of the intent.

The original Constitution promoted economic development in many ways. For example, it resolved the disputes over the West by providing for the admission of new states on equal terms with the old, thereby fostering settlement of the

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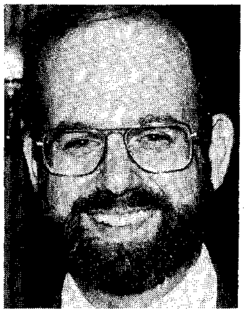

From the President

by Llewellyn H. Rockwell, Jr.

Send *Out* the Clowns

Only in the cloud cuckoo-land that is Washington, D.C., could the budget summit held by the Congress and the Reagan administration be taken seriously.

After the Crash, the politicians panicked. Not because of any harm to the American people, but because such events can hurt all incumbents. The result was a sideshow that—unsurprisingly—has *not* calmed the markets.

As Professor Rothbard points out in this issue (page one), federal deficits and spending do not cause the business cycle, but if we are to prevent the coming inflationary recession from becoming something worse, we have to curb not only the Fed but the spendthrifts in elected office.

True to form, both party establishments are adopting exactly the wrong sort of policies. Instead of—at the very least—cutting federal spending across the board to immediately balance the budget, they are minutely shaving *projected* spending by one or two percent.

Instead of—at the very least—cutting incentive-destroying, business-obliterating taxation, they are increasing it, and spending $1.5 billion more on "tax compliance and enforcement." Instead of repealing the trade barriers raised by the most protectionist administration and Congress since Herbert Hoover, they are increasing them, overtly through quotas and tariffs and covertly by devaluing the dollar.

Given the specter of the Federal Reserve pumping in more "liquidity" to solve the problems its previous inflation caused, we face either an immediate recession or a postponed (and worse) one. That is inevitable. What is not inevitable is the duration and intensity of the bust and the political results that will flow from it.

We can work to influence the politicians. But their reaction to the coming economic debacle shows once again that we cannot count on them to act correctly until we have changed the climate of ideas.

Twenty years ago, politicians talked and acted like statists. Today, they still act the same, but they use our rhetoric. And that's because the people want a change. Thanks to our movement, we have made tremendous intellectual progress.

It is our job to continue that progress, and not to allow the government again to use a crisis to increase its power over us. The example of Ludwig von Mises, in combining scholarship and activism, shows us how to proceed. And the mood of the American people gives us the opportunity. ■

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old-line exchanges—to be tagged as the fall guy for the crash.

Blaming futures or computer trading is like shooting the messenger—the markets—that bring bad financial news. The acme of this reaction was the threat—and sometimes the reality—of forcibly shutting down the exchanges in a pitiful and futile attempt to hold back the news by destroying it. The Hong Kong exchange closed down for a week to try to stem the crash and, when it reopened, found that the ensuing crash was far worse as a result.

Myth Four

A major cause of the crash was the big trade deficit in the U.S.

Nonsense. There is nothing wrong with a trade deficit. In fact, there is no payment deficit at all. If U.S. imports are greater than exports, they must be paid for somehow, and the way they are paid is that foreigners invest in dollars, so that there is a capital inflow into the U.S. In that way, a big trade deficit results in a zero payment deficit.

Foreigners have been investing heavily in dollars—in Treasury deficits, in real estate, factories, etc.—for several years, and that's a good thing, since it enables Americans to enjoy a higher-valued dollar (and consequently cheaper imports) than would otherwise be the case.

But, say the advocates of Myth #4, the terrible thing is that the U.S. has, in recent years, become a debtor instead of a creditor nation. So what's wrong with that? The United States was in the same way a debtor nation from the beginning of the republic until World War I, and this was accompanied by the largest rate of economic and industrial growth and of rising living standards, in the history of mankind.

Myth Five

The budget deficit is a major cause of the crash, and we must work hard to reduce that deficit, either by cutting government spending, and/or by raising taxes.

The budget deficit is most unfortunate, and causes economic problems, but the stock market crash was not one of them. Just because something is bad policy doesn't mean that all economic ills are caused by it. Basically, the budget deficit is as irrelevant to the crash, as the even larger deficit was irrelevant to the pre-September 1987 stock market boom.

Raising taxes is now the favorite crash remedy of both liberal and conservative Keynesians. Here, one of the few good points in the original, or "classical," Keynesian view has been curiously forgotten. How in the world can one cure a crash (or the coming recession), by raising taxes?

Raising taxes will clearly level a damaging blow to an economy already reeling from the crash. Increasing taxes to cure a crash was one of the major policies of the unlamented program of Herbert Hoover. Are we longing for a replay? The idea that a tax increase would "reassure" the market is straight out of Cloud Cuckoo-land.

Myth Six

The budget should be cut, but not by much, because much lower government spending would precipitate a recession.

Unfortunately, the way things are, we don't have to worry about a big cut in government spending. Such a cut would be marvelous, not only for its own sake, but because a slash in the budget would reduce the unproductive boondoggles of government spending, and therefore tip the social proportion of saving/consumption toward more saving and investment.

More saving/investment in relation to consumption is an Austrian remedy for easing a recession, and reducing the amount of corrective liquidation that the recession has to perform, in order to correct the malinvestments of the boom caused by the inflationary expansion of bank credit.

Myth Seven

What we need to offset the crash and stave off a recession is lots of monetary inflation (called by the euphemistic term "liquidity") and lower interest rates. Fed chairman Alan Greenspan did exactly the right thing by pumping in reserves right after the crash, and announcing that the Fed would assure plenty of liquidity for banks and for the entire market and the whole economy. (A position taken by every single variant of the conventional economic wisdom, from Keynesians to "free marketeers.")

In this way, Greenspan and the federal government have proposed to cure the disease—the crash and future recession—by pouring into the economy more of the very virus (inflationary credit expansion) that caused the disease in the first place. Only in Cloud Cuckoo-land, to repeat, is the cure for inflation, more inflation.

To put it simply: the reason for the crash was the credit boom generated by the double-digit monetary expansion engineered by the Fed in the last several years. For a few years, as always happens in Phase I of an inflation, prices went up less than the monetary inflation. This, the typical euphoric phase of inflation, was the "Reagan miracle" of cheap and abundant money, accompanied by moderate price increases.

By 1986, the main factors that had offset the monetary inflation and kept prices relatively low (the unusually high dollar and the OPEC collapse) had worked their way through the price system and disappeared. The next inevitable step was the return and acceleration of price inflation; inflation rose from about 1% in 1986 to about 5% in 1987. As a result, with the market sensitive to and expecting eventual reacceleration of inflation, interest rates began to rise sharply in 1987. Once interest rates rose (which had little or nothing to do with the budget deficit), a stock market crash was inevitable. The previous stock market boom had been built on the shaky foundation of the low interest rates from 1982 on.

Myth Eight

The crash was precipitated by the Fed's unwise tight money policy from April 1987 on, after which the money supply was flat until the crash.

There is a point here, but a totally distorted one. A flat money supply for six months probably made a coming recession inevitable, and added to the stock market crash. But that tight money was a good thing nevertheless. No other school of economic thought but the Austrian understands that once an inflationary bank credit boom has been launched, a corrective recession is inevitable, and that the sooner it comes, the better.

The sooner a recession comes, the fewer the unsound investments that the recession has to liquidate, and the sooner the recession will be over. The important point about a recession is for the government not to interfere, not to inflate, not to regulate, and to allow the recession to work its curative way as quickly as possible. Interfering with the recession, either by inflating or regulating, can only prolong the recession and make it worse, as in the 1930s. And yet the pundits, the economists of all schools, the politicians of both parties, rush heedless into the agreed-upon policies of: Inflate, and Regulate.

Myth Nine

Before the crash, the main danger was inflation, and the Fed was right to tighten credit. But since the crash, we have to shift gears, because recession is the major enemy, and therefore the Fed has to inflate, at least until price inflation accelerates rapidly.

This entire analysis, permeating the media and the Establishment, assumes that the great fact and the great lesson of the 1970s, and of the last two big recessions, never happened: i.e., inflationary recession. The 1970s have gone down the Orwellian memory hole, and the Establishment is back, once again, spouting the Keynesian Phillips Curve, perhaps the greatest single and most absurd error in modern economics.

The Phillips Curve assumes that the choice is always either more recession and unemployment, or more inflation. In reality, the Phillips Curve, if one wishes to speak in those terms, is in reverse: the choice is either more inflation and bigger recession, or none of either. The looming danger is another inflationary recession, and the Greenspan reaction indicates that it will be a whopper. ■

Dr. Rothbard is vice president for academic affairs at the Ludwig von Mises Institute and the S.J. Hall distinguished professor of economics at the University of Nevada, Las Vegas.

Freedom vs. Planning

by Richard Ebeling

As the 20th century began, the most widely held vision of the future was socialist: capitalism would be replaced by central planning and the State would own all the means of production.

The 20th century is ending with the socialist ideal in complete disarray. The heads of socialist governments everywhere declare that economic progress requires individual initiative and private enterprise. They admit that only competition and a market price system can bring economic coordination to a complex system of division of labor.

All of this was anticipated by Ludwig von Mises almost seventy years ago, in his famous 1920 article "Economic Calculation in the Socialist Commonwealth" and in his monumental treatise, *Socialism: An Economic and Sociological Analysis* (1922).

Mises conclusively demonstrated that without market-generated prices, expressed in terms of a common medium of exchange, it is impossible to use society's scarce resources in a rational manner. A central planner might know the technological potentials of the resources at his disposal, but he has no way to know what economic values to assign to those resources. He cannot know how to allocate resources among alternative lines of production, and thus cannot rationally service consumers' demands. This insight means that our choice of economic systems can only be between free-market capitalism and "planned chaos." "There is no third solution, no middle way," says Mises.

It is clear that socialism has lost the war on the battlefield of ideas. But free-market capitalism has not yet won. Both in the United States and around the world, policy-makers promote the "mixed economy," a hodgepodge of competition and State control. Intellectuals on both the collectivist left and the conservative right have enshrined the idea of State intervention.

Capitalism delivers the goods, they say, but the distribution of these goods is "unfair." The profit motive is a powerful engine for individual initiative and creativity, but too often the commodities produced are "socially undesirable" and exist only at the expense of the good society. And while competition is desirable to keep producers on their toes, too much of a good thing can be bad. Thus government needs to protect competitors from "unfair" competition, domestic and foreign.

Free market replies to every one of these arguments for State intervention can be found in the writings of Ludwig von Mises: in *Liberalism* (1927), *Critique of Interventionism* (1929), *Human Action* (1949), *Planning for Freedom* (1952), *The Anti-Capitalist Mentality* (1956), and *Economic Policy* (1979).

What about the argument that capitalism "unfairly" distributes the goods produced by it? Mises demonstrates that the argument is based on a false conception of the free market process. Production and distribution are two sides of the same coin. Production requires the combined use of various factors of production, and labor is one of those resources. Each resource is offered a price, through entrepreneurial judgments, for its service equal to its relative value as a contribution to the production of commodities. Each factor of production contracts for the services it will render before there is a product available for sale.

The entrepreneur develops expectations about what consumers would be willing to pay in the future for the product being considered, and offers wages to laborers and payment for services of other resources.

But who are the consumers? Ultimately, they are the very same laborers and resource owners whom the entrepreneur is considering hiring. It is thus the laborers and resource owners, in their roles as consumers, who determine what their own relative income shares will be. They do so through their decisions about what they wish to buy and what prices they are willing to pay for them.

Thus, if some groups of workers believe they are "unfairly" paid, they have no one to accuse but themselves and the other laborers. They have failed to spend a greater percentage of their income on the particular products that the workers produce.

"Producers" and "consumers" are really the same people. And because this is always true in the free market, the second charge against free-market capitalism, that it produces "socially undesirable" products, also fails.

First, as Mises forcefully argued, there is no dichotomy between "society" and the individuals comprising it. Nothing happens to or for "society" that doesn't originate with the individuals whose actions create societal relationships.

Second, in the free market, competition makes the entrepreneur the servant and not the master of the economic process. The entrepreneur must ultimately supply what individuals in their role as consumers demand. An entrepreneur who fails to do this will be driven from business and other entrepreneurs more sensitive to consumer wishes will replace him.

Finally, when people say that some product is "socially undesirable," they really mean that people in society are demanding things of which they disapprove. But rather than attempt to use reason to persuade others to change their buying preferences, they want to use government to coerce them into abstinence. To answer this, Mises argued that freedom is indivisible. Once it is admitted that government has the right to infringe on the peaceful and personal preferences of individuals in one area, State interference cannot logically be excluded from other spheres. At the end of this road is the totalitarian state (see *Liberalism*, pp. 52-57).

In *Human Action*, Mises showed that free markets mean social cooperation, not social conflict. It is through this process of competition that we know who, among the various suppliers, can most successfully satisfy consumers' demands at the least cost and, therefore, at the lowest price. And through this process each individual finds his most efficient and profitable place in the social system of the division of labor.

He who asks for State protection from the rigors of competition, Mises explains, is asking for special privilege at the expense of the other members of society. He is demanding special regulations, tariffs, or subsidies to receive a higher relative income than others in the free-market economy are willing to pay him for his products or services.

If the government grants the special privilege, the results are disruptive of the peaceful free market process of economic change and progress. When other members of society begin to obtain government privileges and protections, the cumulative effect is declining production, less innovation, higher prices, and a lower standard of living for the members of the whole society.

Mises's most important contribution to understanding the fallacies of State intervention is his demonstration that "the middle-of-the-road leads to socialism. "All government interventions and regulations are inherently destabilizing and disruptive. And the logical consequences of one set of interventions is that the government will extend its controls to more and more sectors of the economy to "repair" the damage created by the first set of controls.

If for example, the government imposes price controls in one part of the economy, the controls will distort the existing free-market relationships between prices and the costs of production. If the controlled price is set below the costs of production, sellers in that part of the economy will no longer be able to produce the same amount of the product as before. If the government wants high production levels, it must extend the price controls to the prices of the factors that go into making that product. But those factors of production have, in turn, been produced with other resources whose prices will also have to be controlled.

The interdependency of all prices and all markets in a system of division of labor means that if the government decides to control one part of the economy, it must end up controlling all of it. Finally, when the controls and regulations pervade every portion of the economy, the free market is completely supplanted by the State, and socialism replaces capitalism through piecemeal interventionism. In short, as Mises says, "the middle-of-the-road policy is not an economic system that can last. It is a method for the realization of socialism by installments."

But what would *logically* happen if government remains on the interventionist road is different from what must happen.

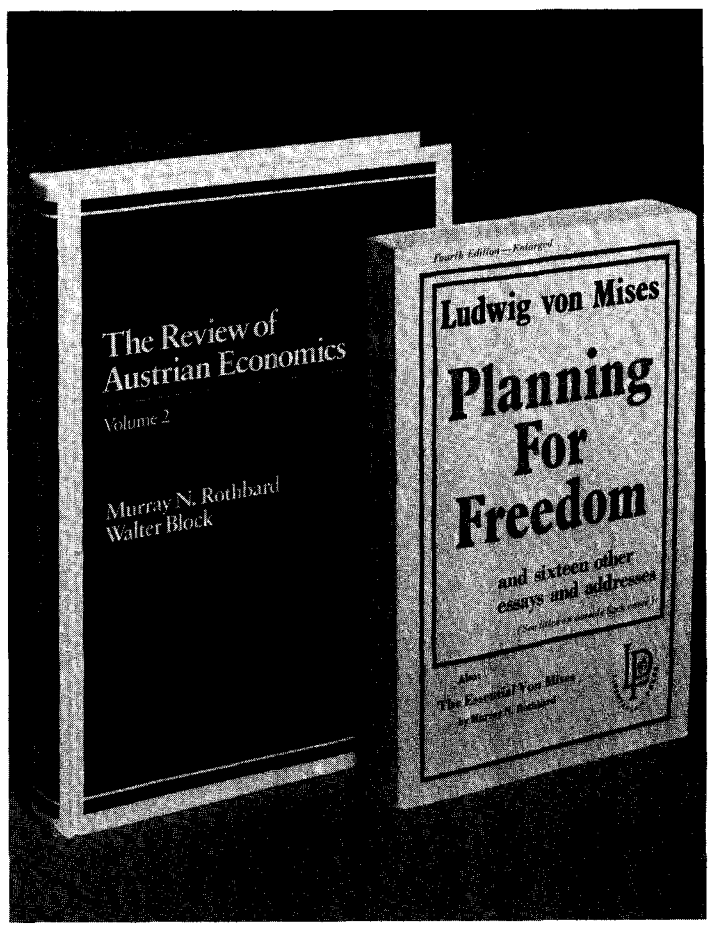
Mises repeatedly observed that the western world was moving toward collectivism. But he also emphasized that "the trend can be reversed as was the case with many other trends in history." In the realm of human action no choices are "inevitable." History is made by men, and men are ultimately guided by ideas.

A victory for free-market capitalism is possible. Just as theory and experience refuted the case for socialism, the same can happen to State intervention and the "mixed economy."

In fact, in terms of practical results, State intervention is already defunct. But people must be shown how to read the signs left behind by a controlled, taxed, and welfarist "mixed economy." People must understand why it happened and what it demonstrates, that if we want peace, prosperity, and liberty, there is no alternative to free-market capitalism.

Thanks to Ludwig von Mises, we have the arguments and insights to lead us in the battle of ideas. ■

Professor Ebeling teaches economics at the University of Dallas and is an adjunct scholar of the Mises Institute.



Volume II of the Institute's hardbound Review of Austrian Economics *is $30. The paperbound* Planning for Freedom *is $8. Both prices include postage and handling.*

Roads, Jobs, and the Problem of Government

by John Semmens

A persistent myth says that government spending creates jobs, especially when spent on "public works" like roads, highways, and bridges. But this forgets Mises's rule on public works: when the government spends on them, it "abolishes on the one hand as many jobs as it creates on the other."

As a transportation economist, I repeatedly have to tell people that highway projects result in zero net job creation. But people rarely believe me: official estimates purport to show that for every $1 million the government spends on roads, it creates 50 new jobs.

What this oft-cited official statistic does not say is that every million dollars taxed from the people to build or work on roads is a million dollars that would have been spent on something else. Raising taxes and employing road builders may make 50 new jobs, but these are offset by an equivalent decline in other sectors of the economy.

Still, the official statistic is what appears in press releases, speeches, and official reports on the economic impact of higher taxes for highways. It is cited most often, of course, by politicians who make their living with baseless economic promises.

To see the fallacy, one need only use Henry Hazlitt's rule: "The art of economics consists in looking not merely at the immediate but at the longer effects of any action or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups."

Suppose the government raises $1 million by imposing a fuel tax. The million dollars paid in fuel taxes is money taken directly out of the consumer's pocket. That money would have been spent on other purchases that would have provided jobs for clerks, salesmen, managers, truck drivers, wholesalers, farmers, etc. The job opportunities must decline in these sectors because the revenues necessary to support them have been diverted to highway construction. The tax also destroys potential job creation in those sectors.

If on net no jobs are created, the money spent on roads has to be justified on different grounds. But, as it turns out, government roads have few merits at all. For one thing, expenditures on roads are not a good investment. Empirical studies show that they have been losing money for years, with more money being spent on maintenance, administration, highway patrol, depreciation, and interest than is actually being raised to pay for them. As in all government-run activities, there are built-in disincentives that prevent the efficient use of resources.

But the public needs and wants roads, so we find ourselves at a seeming impasse. What is to be done?

As with so much else, the solution is to turn the roads over to the private sector. Let them be operated like any other enterprise. Only in this way can consumers (road users) get the services they want at a price they want to pay.

Under private ownership, road managers are subjected to the discipline of the marketplace, and only then will they face incentives sufficiently powerful to promote cost-effective use of scarce resources. And since the money used to build and repair the roads will be raised by entrepreneurs—and not taxed from the public—there will be no destructive effects on the labor market. Jobs are created through production in response to consumer demand. Only when roads are privately owned can we speak of how many jobs a road creates.

There is another point. We are all familiar with the mind-numbing, time-wasting waiting in line that is typical of socialist economies. This is caused by shortages which result from government ownership and the lack of a free-market pricing system. And without money-prices, there can be no rational economic calculation. And it is this very phenomenon—no free-market prices and no economic calculation—that we witness in traffic jams every day on government-owned roads in America.

The services provided by roads are too important to be left to a socialistic, government monopoly. We are then left with a choice: we can watch the situation deteriorate to a norm of traffic jams and poor service, or we can privatize. For those of us who have read Ludwig von Mises, the choice is not a hard one to make. ■

Mr. Semmens is a transportation economist with the Arizona Department of Transportation. The views expressed here are, of course, entirely his own.

Review of *Planning for Freedom*

by Jeffrey A. Tucker

Planning for Freedom is a sparkling collection of essays and speeches by Ludwig von Mises prepared in the late 1940s and early 1950s. Each one of the 16 contributions is a lucid and brilliant exposition of the virtues of reason over emotion, of science over myth, and of freedom over central planning.

It contains powerful refutations of socialism in all its varieties, and predictions about our future of Statism that proved all too accurate. But more than just a critique, *Planning for Freedom* is an inspiring program for action.

When Mises wrote these essays, he was surrounded by cries for more State planning. Socialism was the most popular system. It was alleged to be superior to all others. Under such a system, the State would own all the means of production, direct all investments, tax profits, control prices, and provide welfare. And the whole program was to be enforced by police power. This was the "progressive" program, imposed through the threat of violence, and the one necessary to save us from the evils of capitalism.

These progressive socialists, and their interventionist counterparts, rarely attempted a refutation of free-market arguments. As Mises shows, they smeared their opponents, engaged in *ad hominem* attacks, and stuck erroneous labels on all those who disagreed with them.

This volume contains a freedom fighter's reaction to the socialist campaign. Mises refutes the socialists' ideas, exposes their fallacies, paints a grim picture of where their ideas will lead, and proposes a program for liberty and opportunity.

Mises' two best essays in the book are "Middle-of-the-Road Policy Leads to Socialism" (1950) and "Stones into Bread, the Keynesian Miracle" (1948).

In the first, Mises skewers the interventionists, showing that their program is not a "golden mean" because an interventionist economy cannot be permanent. Intervention affects the structure of pricing, the network of interconnected prices, and thus each intervention must necessarily lead to another if the government intends to maintain the artificial results.

The logical outcome of this "middle-of-the road" policy is a command economy where the State directs all pricing and production. Thus there is no third way; the choice is between control and freedom.

Mises's principle of "no-compromise" led him to admonish his students when they failed to understand the true character of intervention. Thus the reader discovers Mises's strong disagreements with F.A. Hayek's position on the welfare state. Mises notes that in *The Constitution of Liberty,* Hayek makes a distinction between the tendency to welfarism, which is "compatible" with liberty, and the different tendency toward all-out socialism. But, following the logic of interventionism, Mises says "the Welfare State is merely a method for transforming the market economy step by step into socialism."

In "Stones into Bread, the Keynesian Miracle," Mises produces what is still the best short essay on Keynes's fatal weaknesses in theory and policy.

Mises also recalls Keynes's "malicious description" of the Paris Peace Conference in which he "tried to ridicule his adversary by broadly expatiating upon his clothing and appearance which, it seems, did not meet with the standard set by London outfitters."

But Keynes's predilection for stylish clothing over serious economics was just the beginning of his problems. He totally misunderstood the nature of trade unions, unemployment, wages, prices, capital, money, the business cycle, international trade, and much more.

The prevailing myth is that Keynes caused a revolution in economic policy. But as Mises sees it, "the 'Keynesian revolution' took place long before Keynes approved of it and fabricated a pseudo-scientific justification for it. What he really did was to write an apology for the prevailing policies of governments. This explains the quick success of his book."

While Keynesian economics is intellectually dead, Mises warns that "no one should expect that any logical argument or any experience could ever shake the almost religious fervor of those who believe in salvation through spending and credit expansion."

The volume also contains an essay on the necessity of a pure gold standard and much more. Overall, *Planning for Freedom* shows that Ludwig von Mises was a deeply committed reformer as well as scholar. It's a volume to treasure for its depth, brilliance, clarity, and truth, and an inspiration to action as well. ■

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vast interior. Provision for duty-free interstate trade increased productivity. The Constitution made state governments less intrusive by prohibiting their issuance of paper money and their passage of laws impairing the obligation of contracts.

By the mid-19th century, rapid economic growth had become the normal condition of the economy. But under the surface an irresolvable contradiction was growing. The lump that would not digest was slavery.

In view of its importance in the southern economy and the deep disagreements between northerners and southerners about it, slavery received scant mention in the original Constitution. (The words "slave" and "slavery" do not appear at all.) Congress could not interfere with the international slave trade for 20 years; slaves escaping into free states had to be returned; and three-fifths of the slaves were counted in determining representation in Congress. Otherwise the Constitution left slavery to the states.

By the mid-19th century, rapid economic growth had become the normal condition of the economy.

For seven decades a succession of political compromises kept the conflict between North and South from boiling over, but finally either the will or the ability to fashion acceptable compromises ran out, and the Civil War ensued.

In the war's aftermath the old Constitution was fundamentally altered. The Thirteenth Amendment abolished slavery. The Fourteenth guaranteed to all citizens, including the freed slaves, protection from state actions that would abridge the privileges and immunities of citizenship, deprive them of life, liberty, or property without due process, or deny them equal protection of the laws. The Fifteenth Amendment guaranteed the right of the freedmen to vote. The amendments of the 1860s transferred power from the states to the national government. Though disputes over states' rights persisted, claims of dual sovereignty lost most of their force.

During the post-Civil War era Americans enjoyed unprecedented economic growth, an achievement favored by the Supreme Court's insistence that due process of law included protection of economic liberties—rights of private property and freedom of contract. Then, government actions caused the economy to plunge into deep depression in the early 1930s. Governments at all levels responded by expanding their powers over economic affairs. At first the Supreme Court resisted many of these measures. Starting in 1937, though, the Court reversed so many important decisions on economic matters that its turnabout must be considered a constitutional revolution. The heart of the Court's new position was a broad reading of the Commerce Clause. Practically everything, no matter how manifestly local, was seen as part of interstate commerce and therefore subject to regulation by Congress and its agencies.

During the past 50 years the United States has developed a welfare state not much different from those of Western Europe. Economic affairs, once overwhelmingly private, have become pervasively politicized. Taxes now equal 40% of the national income—up from 13% as recently as 1929. The free market economy has come to be regulated in minute and expensive detail, with the costs born largely by consumers. Citizens have lost much of the economic liberty their ancestors esteemed.

American traditions and political pressures have kept the government from totally destroying all private property rights. But the Constitution, which formerly served to guarantee economic liberties, no longer provides much if any substantial protection. One may well doubt whether the economic dynamism that made the average American rich by world standards will prove permanently compatible with a constitutional regime so permissive of governmental intrusion into economic affairs.

But the Constitution can be changed, as it has been changed before. In 1865 the Constitution gave the slaves freedom from their masters. We can hope that someday the Constitution will be changed again to give all Americans economic freedom from our masters in Washington. ■

Dr. Higgs is the William E. Simon professor of political economy at Lafayette College and an adjunct scholar of the Ludwig von Mises Institute.

Quote of the Month

"If the practice persists of covering government deficits with the issue of notes, then the day will come without fail, sooner or later, when the monetary systems of those nations pursuing this course will break down completely. The purchasing power of the monetary unit will decline more and more, until finally it disappears completely." —Ludwig von Mises ["Stabilization of the Monetary Unit," 1923]

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