An exclusive interview

Economics Professor Murray N. Rothbard explains why inflation must lead to recession or depression

Dr. Murray N. Rothbard is an economic analyst, scholar, and prolific author. For 27 years he has studied economics with special emphasis on the workings of free market capitalism.

Dr. Rothbard received his Ph.D. in economics from Columbia University. In post-graduate studies at New York University, he studied with Professor Ludwig von Mises, economist and author of Human Action. Dr. Rothbard’s theoretical work developed from the logical, laissez-faire approach successfully advanced by Mises. Today Dr. Rothbard is Professor of Economics at the Polytechnic Institute of Brooklyn.

Dr. Rothbard is author of America’s Great Depression, Power & Market; Man, Economy and State: The Panic of 1819; and What Has Government Done to Our Money? His new book, For a New Liberty, will be published by MacMillan early next year.

Dr. Rothbard has contributed articles to In Search of a Monetary Constitution, On Freedom and Free Enterprise and 4 other books.

His articles and interviews have been published in the New York Times, Intellectual Digest, The Freeman, Human Events, Quarterly Journal of Economics, American Economic Review and dozens of other publications, both popular and scholarly. He is the Editor of the Libertarian Forum, a monthly newsletter published in New York City.

PCCE’s exclusive interview with Dr. Murray N. Rothbard took place in his New York City residence. Our interview opened with a discussion of 2 problems that have long plagued investors— inflation and depression.

PCCE: Professor Rothbard, in your book, America’s Great Depression you say that the business cycle of booms and busts doesn’t happen randomly; instead, one phase of the business cycle follows almost logically from the other phase. What’s the cause of this?

ROTHBARD: That’s an important point to stress; because most economists today think of the parts of the business cycle as being unconnected with each other. We have a boom. We have a depression. These come from on high, so to say, then the government does something to correct them. There’s no understanding, among most economists, that the business cycle is an interconnected whole.

Essentially, the business cycle is caused by inflation. Once you have an inflationary boom, then recession or depression becomes inevitable. There’s no way of getting away from it.

INFLATION

PCCE: What produces inflation?

ROTHBARD: An inflationary boom is triggered and fueled by bank credit expansion which, in turn, is generated by the central banking system under the control of the national government.

PCCE: How does that work?

ROTHBARD: The Federal Reserve System buys... (continued on page 2)
government bonds on the open market. Let's say it buys a $1,000 bond from a dealer. It gives the dealer a check for $1,000 drawn on the Federal Reserve System.

The dealer deposits the check in his bank. As soon as the deposit is made, the bank's reserves go up by $1,000. Then the bank can make more loans—the exact amount depending on the legal reserve requirement.

Right now the reserve requirement is about 17%. This means the bank has to keep 17% of the $1,000 deposit—$170—on hand. It lends out the other 83% or $830.

Somebody deposits that $830 in their own bank. In turn, their bank loans out 83% of the $830, or $688. After a while, you wind up with a $5,000 expansion of the money supply on the basis of the original $1,000.

You can see the process very simply if you assume there's one monopoly bank in the country. Let's say every bank was a branch of the Bank of the United States. In this case, the bank would put that $1,000 into its reserve and lend out $5,000, thereby keeping within the 17% legal reserve requirement.

So the way the government expands bank credit is to have the Federal Reserve buy bonds. It's an arcane but very important setup—a quiet process that gets almost no publicity at all because it's not a dramatic thing.

PCCE: And that's the actual forerunner of inflation.

ROTHBARD: Yes. All schools of economics agree that increasing the money supply and bank credit causes price inflation and creates an inflationary boom.

THE CONSEQUENCES OF INFLATION

PCCE: What happens during an inflationary boom?

ROTHBARD: You get important, but not easily visible, distortions in the production system. An inflationary boom leads to an overexpansion of long range capital investment (industrial raw materials, machine tools, plants and so forth), and an under-investment in consumer goods.

PCCE: How does the expansion of bank credit misdirect investment into the capital goods industries rather than consumer goods?

ROTHBARD: When the government, through its central bank, stimulates bank credit expansion by increasing the cash reserves of all the national commercial banks, the interest rate is pushed down below its free market point. In other words, as the supply of bank loans increases, the interest rates decline.

The lower interest rates make long term projects which previously looked unprofitable to businessmen, now seem profitable, and they borrow more money to invest in capital goods. As a result, wage rates and prices of raw materials are bid up.

PCCE: Why is this important?

ROTHBARD: The problem comes when the workers and landlords—who received wages and rent from the businessmen—begin to spend the new money. They consume and save in the same proportions as before the credit expansion—they don't save and invest enough to finance the purchase of the newly produced capital goods. So when the government stops its bank credit expansion, as it inevitably has to do, the boom stops.

Then the unsound over-investments of the boom are liquidated, and depression follows. So the depression or recession eliminates the wasteful investments and shifts resources back to consumer goods.

PCCE: Is this why entrepreneurs who have been successful, profitable businessmen for 5, 10 or maybe even 25 years, suddenly go bankrupt when a depression hits?

ROTHBARD: Yes. The shift from capital goods to consumer goods leaves many businesses stuck with more capital goods than they can afford to pay for, so they go bankrupt.

PCCE: How long does this process take?

ROTHBARD: The whole process could begin and end within a period of 3 to 4 months. You might say then, well how come the inflationary boom usually lasts for many years?

The reason why the recession doesn't catch up with the boom immediately and end it naturally, is because the banks keep on inflating. There isn't just the one sharp credit expansion or one sharp inflation—it's a continuing process where the mechanical rabbit always keeps one step ahead of the dog that's chasing it.

And it's difficult to keep always one step ahead of the cost squeeze. They have to inflate more and more as time goes on, never allowing the rise in costs in the capital goods industries to catch up with the inflationary rise in prices. They increase money and credit even more than before just to keep up with the new increase in prices.

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THE GOLD STANDARD

PCCE: Why can't a government just continue inflating the money supply forever?

ROTHBARD: The reason depends on whether or not you have a gold standard. In the old days, while we were still on the gold standard, the banks could not continue inflating forever, because as they'd pyramid more and more money and bank credit on top of gold, the public would get scared. And as the public got scared, it would start withdrawing gold from the banks.

Moreover, we'd have a balance of payments problem. The inflated credit would lead to higher prices at home and to greater incomes. People would spend more on imports. Exports would fall off because of our higher prices and gold would start flowing out.

So you would have an increasing pyramid of credit on top of a decreasing gold base. The banks would eventually get into deep trouble. They'd have to stop and then contract their credit.

PCCE: Is that what happens in a bank panic?

ROTHBARD: Yes! Exactly — deficits in the balance of payments. The banks and government panic, because how do you retain gold redeemability until you stop increasing credit. Then there are runs on the banks. The result of all this is a contraction of the money supply and a decline in prices.

Incidentally, this is what happened in the late '20s. The 1929 depression was triggered by a consistent deficit balance of payments — a constant outflow of gold from the American banking system.

Now that we are off the gold standard, this constraint no longer exists. The balance of payments constraint hasn't existed since August 15th, 1971, when President Nixon repudiated the gold obligation altogether.

But coming back now to your previous question, when you don't have a gold standard there's still one final restraint on unlimited eternal bank credit expansion — that's runaway inflation. If you keep up the acceleration of the money supply this will lead to an accelerated and runaway inflation of prices. This has happened to many countries in the twentieth century.

Runaway inflation, of course, means a currency collapse and chaos.

RUNAWAY INFLATION

PCCE: Is runaway inflation a possibility in America?

ROTHBARD: Yes, and as a matter of fact, that's one of the reasons why the Nixon administration put the lid on the money supply for a while. In the 1950s, prices were going up by something like 1 to 2% per year, which doesn't sound like very much. During the Kennedy administration prices were going up about 3 to 4% per year and during the Johnson administration prices went up about 6% per year — sort of an exponential increase.

PCCE: Also, Professor Rothbard, in the 1960s the money supply was growing at about 3.4% per year. In 1970 it went up to 5.4%. In 1971, it increased to 6% and this year it looks like its going to increase between 8 and 10%.

ROTHBARD: Yes, it's around 8 to 10% now.

PCCE: Then what you predicted about the money supply increasing is happening. So runaway inflation, which happened previously in America —

ROTHBARD: —Yes, runaway inflation has already happened several times in America. The first time was during the Revolutionary War when the American Revolutionary Government put out the so-called Continentals — paper money which depreciated astronomically. Towards the end, something like a thousand Continental dollar bills were worth only one gold dollar. Finally, the Continentals disappeared altogether, which is the origin of what used to be a famous phrase: "Not worth a Continental." The result of that runaway inflation was a healthy distrust of paper money which lasted for a long time.

The next big episode was the Civil War. In the South they had a runaway inflation.

In the North, there wasn't a runaway inflation, but the greenback went down to something like a third. In California, for example, where there was a lot of gold, it was used as money throughout the Civil War. There you had a situation where a greenback — a paper dollar — was down three to one. Prices and goods were triple in terms of greenbacks, and still the same in terms of gold. This makes it obvious that the cause of inflation is not unions or businessmen or greedy speculators or whatever, but the government which has issued too much money.

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WHY UNHAMPERED CAPITALISM IS DEPRESSION-FREE

PCCE: Then the boom and bust cycle is not really part of the free market.

ROTHBARD: No, certainly not. In a free market, you have fluctuations of various sorts, for instance seasonal. An example I like to use is the seven-year locust cycle. Locusts come, say every seven years. So every seven years there's a boom in locust-fighting equipment. People use it, but after the seventh year is over, the locust-fighting equipment business is phased out.

And you may have other types of fluctuations — a decline in horse-and-buggy business replaced by a big increase in automobile business, and so forth. But you don't have an overall business cycle.

PCCE: But, Professor Rothbard, why can't individual banks simply expand credit?

ROTHBARD: Suppose one bank — the Rothbard Wildcat Bank of Northern Minnesota which, say, I own — decides to issue paper money and new bank deposits or whatever. The Rothbard Wildcat Bank will lend them out because this is how the bank makes its profits.

Shortly after I lend them out, my customers will take this new money — either paper money or bank deposits and buy equipment, food or something. They'll buy from clients of some other bank. As soon as they do that, the other bank will call upon me for redemption.

I'll have to pay up in cash — in gold, silver or whatever the monetary standard is. If I don't have the money to redeem it, I'll go bankrupt.

That salutory check of bankruptcy keeps individual banks on the free market from expanding credit very much. However, if there's a Federal Reserve System or Bank of England around to supply individual banks with new reserves and to coordinate the inflation, this is when you will have an inflationary credit expansion.

WHY THE GOVERNMENT FOLLOWS INFLATIONARY POLICIES

PCCE: Why does the Federal Reserve System expand bank credit?

ROTHBARD: The government needs money to pay its bills. It's running a deficit, which of course increases the national debt. It doesn't want to raise taxes, so it engages in deficit spending.

Whether or not the deficits are inflationary and lead to business cycle distortions depends on how they're financed. There are 3 ways.

First, the government could simply print money and spend it. This would be inflationary — it would raise prices. However, (a) it would not cause the boom and bust business cycle because it would not be loaning money out to business and thereby distorting interest rates; and (b) there would be no increase in taxes.

Second, is for the government to sell bonds to the public. If you or I bought the bonds, we'd simply write out a check on our bank. The Treasury would get the check and spend it on missiles, paper clips or whatever. So the money would circulate but would not increase. This would not be inflationary. However, it would mean the taxpayer would have to kick in and pay the money back plus interest. So it would increase taxes. The government doesn't like this alternative because they have to pay a higher rate of interest to us than to the banks who are, in a sense, creating money out of thin air and therefore charge a lot less.

So instead, our government chooses the third method — selling bonds to the banking system — which combines the worst features of both. It raises taxes because the public has to pay interest to the banks. It's also inflationary and causes the boom and bust business cycle.

But financing the national debt is not the only reason why the government expands bank credit. It also does so in an attempt to smooth out the ups and downs in the price level. The idea here is to manipulate the money supply by taking out money when prices are going up (and thereby lowering prices), and pumping money in when prices are falling (and thereby propping up prices).

First, keeping the price level constant is an erroneous objective. It's an inflationary objective because an unhampered capitalist system would result in a steadily falling price level — and it always has — once inflationary bank credit is eliminated from the picture.

Then, in practice, the Federal Reserve System simply can't manipulate the price level accurately. There's a problem of statistical lag; a time and information lag. For example, suppose there's a recession in November of 1972. There are bankruptcies and prices are falling. First, it takes about two months to gather the statistics and ship them to Washington. So it's about January or February before the government finds out that the prices were falling in November. Then the government has to decide whether this is just a temporary dip, or a trend. That takes a few more months to figure out, and brings us to April or May. Then the government needs another few months to decide what to do about it.

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By this time, you're into July or August. Finally the government starts doing something. Let's say it pumps money in to offset the recession. It takes another few months for the impact of the August decision to be felt in the economy — and that's around next November.

Already a year has passed — you might well be in another phase of the business cycle. Quite likely the prices are going up, so all the government's action will do is aggravate the inflation.

Nevertheless, the Federal Reserve System has assured bankers that we could always stabilize the price level. Indeed, the price level was stabilized in the 1920s. As a result, many economists said there's no inflation and therefore there can be no depression.

One of the very few economists who predicted a depression during the late '20s was Ludwig von Mises. What Mises said was that this seemingly non-inflationary situation was deceptive; that there would have been a fall in prices if not for the inflationary credit expansion in the United States and Europe.

Because of this inflationary credit expansion, he predicted there would have to be a bust really soon — and that there would be a severe recession or depression. As we all know, Mises was proved right.

PCCE: Are there parallels between then and now?
ROTHBARD: Yes, definitely — there are ominous parallels.

We'll examine these parallels in the next issue of the Gold & Silver Newsletter.

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**Gold & silver news briefs**

**SILVER**

- Berkey Photo is introducing its new instant picture camera in time for the holiday season. Promotion will include television, photographic publications, newspapers and other media.
- Polaroid is introducing its new SX-70 camera in Florida. Sir Lawrence Olivier will be the spokesman for the TV commercials. Next year Polaroid will spend $20 million to advertise the SX-70.
- Kodak is coming out with a new, popularly priced motion picture projector featuring 5 projection speeds, including slow motion, plus automatic film threading.
- Kodak posts record sales and earnings. Third quarter sales up 15%, and net earnings up 28% from the year before. Franklin Mint continues setting sales and earnings records. Third quarter earnings up more than 30% from the year before.
- Since October 1971, 21 countries have issued 60 coins containing silver. West Germany was the leading silver coin producer, issuing 60 million 10-Mark coins commemorating the Olympic Games.
- Domestic silver production for the first 8 months of this year 3% under last year's.
- Hecla Mining silver production down 7.9% through the first 3 quarters.
- England's silver bullion stocks down about 80 million ounces this year.
- Last issue, we reported Comex silver stocks down 30 million ounces to 91.5 million ounces. Downtrend continuing. Comex now down to 84.0 million ounces.
- International Investor calls silver "one of the soundest investments available today," and says it "offers one of the finest hedges against continuing inflation and monetary disorders."

**GOLD**

- Fire in Vaal Reefs, an important South American gold mine, has cut production 50% in section of 1 shaft.
- Inflation hurting Homestake Mining, the largest North American gold mine which is responsible for 35% of all gold mined in America. Because of rising costs, Homestake now needs a gold price between $55 and $60 per ounce to break even. This will tend to preclude all but a brief dip below $55 per ounce.

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As we predicted in the August Newsletter, gold prices dipped slightly. Heavy Russian gold sales — 100 to 200 tons — and profit taking are apparent causes. [South African gold production for the first 9 months of 1972, down 6.7% from 1971. R. A. Plumbridge, Executive Director, Gold Fields of South Africa, Ltd. says, "The recovery of by-product gold is not expected to be materially increased."

Domestic consumption of gold up 8.6% in 1972. Jewelry and arts up 7%; dental use up 8%; industrial, space and defense uses up 17%. Swiss bankers estimate commercial demand for gold now tops production by 6 to 8 tons per week.

First gold futures trading began mid-November on the Winnipeg Commodity Exchange. Demand was reported "brisk." Financial World calls gold "the most stable, most indestructible, most universally desirable commodity that man has ever known."

Higher gold prices predicted

Holt Investment Advisory predicts $100 per ounce price for gold within a few years. Myer's Finance Review predicts $100 per ounce is inevitable. Paul Henshaw, President of Homestake Mining, predicts $105 per ounce. Financial Markets Review calls $70 gold a "halfway house."

The Northern Miner predicts that $70 "will not be the end of the [upward price] movement, which will have to go far above $100 per ounce in order to come to a halt." Dr. Franz Pick, world famous monetary authority, predicts that the rising price of gold will not stop at $100 per ounce "or $140 . . . in the future I can visualize $175."

Gold & Silver Symposium in New York

Silver coins, silver bullion and gold were the topics covered by several experts at a Symposium sponsored by the American Association of Commodity Traders (AACT) in November.

Arthur N. Economou, President of AACT and Editor of the Commodity Journal, said: "The potential for an overwhelming bull market is there. At some time . . . silver prices will skyrocket." Mr. Economou emphasized that "Silver coins are an almost perfect investment medium, because the coins' face value provides a floor below which the price cannot fall . . . A bag of silver coins with $1,000 face value can always be spent for $1,000."

Michael Foley, metals analyst with CBWL-Hayden, Stone, speaking about Winnipeg's new gold futures contract, said: "Many people buy gold for financial protection. There isn't a country in the world where paper money has increased in value — rather, paper currency always tends to depreciate. But gold has been a store of value for thousands of years, and many people define their life savings in terms of gold. So no matter how high the price of gold may go, many people will keep their gold and even buy more. When we go through the next currency seizure, people will turn to gold in a thundering stampede."

HOW AMERICANS CAN BUY GOLD COINS LAWFULLY

American law draws an important distinction between INVESTING in gold coins and COLLECTING them.

In 70 countries outside of America, where gold ownership is legal, knowledgeable investors protect their assets against inflation, devaluations and depression by investing in gold and gold coins. If you are an American, Federal law forbids your doing this.

However, it is PERFECTLY LAWFUL for you to COLLECT GOLD COINS for their numismatic value.

You may purchase gold coins on a cash basis through us simply by paying the price in full. Delivery to points outside the immediate area is usually made by insured mail. You are not charged for delivery.

The price of gold coins may change at any time, so we cannot give you an exact price in this Newsletter. If you call us collect at (213) 595-4687 during normal business hours (8:00 a.m. to 5:00 p.m. weekdays and 9:00 a.m. to 2:00 p.m. Saturdays), we will give you the day's price. If you decide to buy, we will trust your word and confirm your order directly over the phone. You can then send your check for the exact amount.
Part 2 of PCCE’s exclusive interview with Professor Murray N. Rothbard —

**What lies ahead for America**

In the concluding half of this interview, Professor Rothbard takes a close look at what lies ahead for America — and he’s not pleased with the outlook. Here are a few of the subjects Professor Rothbard tackles:

- The parallels between 1929 and today.
- Why the Great Depression of the ’30s was so severe and extended.
- How wage and price controls lead to shortages, rationing and bankruptcies.
- How budget deficits affect interest rates.
- The little-known but important link between interest rates and stock market prices.
- What’s causing America’s record balance of payments deficits — and do international trade wars lie ahead?
- Does America face worse inflation?
- What change in the international monetary system will clear the way for a world-wide runaway inflation.
- Warning sign: An event that could trigger a world-wide depression.
- How to protect your assets.

In the first half of this interview, Professor Rothbard explained why inflation must lead to recession or depression. Indeed, the seeds of depression are planted when the government creates an inflationary boom by expanding bank credit and the money supply through its central banking system. (In America, the central banking system is the Federal Reserve.)

On one hand, the expansion of bank credit lowers interest rates below their free market level. This leads entrepreneurs to make uneconomical overexpansions in the capital goods industries.

On the other hand, the expansion of the money supply raises prices. This tends to make the nation’s goods uneconomical in world markets, which leads to balance of payments deficits. These deficits, for reasons which Professor Rothbard explained, often lead to bank panics and failures which act as the trigger for the depression which inevitably follows an inflationary boom. During the depression, credit contracts: resources shift from capital goods industries; and mass bankruptcies liquidate unsound overexpansions.

When a nation is not on a gold standard, the result can be still worse — a runaway inflation, which means “a currency collapse and chaos.”

Part 1 of this interview closed as Professor Rothbard was about to explain the parallels between 1929 and today. We’ll continue from this point.

— Editor

**THE PARALLELS BETWEEN 1929 AND TODAY**

PCCE: In addition to overoptimism about the country’s economic health, what other parallels do you see between now and 1929?

ROTHBARD: For a clear understanding, we should first examine what caused the Great Depression of the 1930s, and then examine what’s happening today.

Let’s start with World War I. During the war, the countries of Western Europe inflated their currencies to finance the war effort. To do this they went off the gold standard. This lead to competing devaluations, exchange controls and protective tariffs. The monetary system was chaotic and the whole international trade picture was shot.

So after the war the problem was how to reconstruct the monetary system.

The intelligent thing would have been to go back to the gold standard at the then current par and start from there. But the British insisted on going back to their pre-war par which was something like 60% higher.

Going back to the pound at an over-valued par created a deflationary situation. It meant that British prices were no longer competitive in world markets — yet Britain lives by foreign trade.

The classical solution would have been deflation — contracting the money supply and lowering prices. The British couldn’t do that because they were heavily unionized — and the unions were against deflations.

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The only thing left for the British to do, to avoid an outflow of gold, was to induce other countries to inflate along with them. In the end they induced the United States to inflate the dollar and keep American prices up.

So at various times from 1921 to the crash of 1929, the Federal Reserve inflated the money supply by buying bonds heavily in the open market. This pushed interest rates below the free market level, and inflated the money supply by about 50%. (The rate of inflation is substantially faster today than in 1929. — Editor)

The inflationary boom lead to the inevitable overexpansion of long-range capital investment, and underinvestment in consumer goods. Stock market and real estate prices boomed. Yet, this inflation was masked because wholesale prices were stable. The result was the stock market crash of 1929 and the beginning of the worst depression in modern history.

So, to come back to your previous question, we see 3 important parallels between 1929 and today: government expansion of bank credit and the money supply; stock market and real estate booms; and balance of payments deficits.

HOW WELL-INTENDED
GOVERNMENT POLICIES PROLONGED
THE DEPRESSION
PCCE: By 1932, hundreds of thousands of businesses had gone bankrupt. One out of every four workers was unemployed. Why was this depression of the 1930s so severe and so much more extended than previous depressions?

ROTHBARD: It was bound to be severe because of the large inflation that had taken place. But in 1921, we started off with a depression just as severe, and it was very short. Why, then, wasn't the Great Depression of the '30s as short?

Well, before 1929, the policy of the Federal Government during an American depression was generally laissez-faire. For example, during the depression of 1921, President Harding didn’t intervene in the economy. So prices fell sharply, shaky businesses collapsed, and there was heavy unemployment. But in 9 months the whole thing was over.

President Hoover abandoned this sound economic policy with the Great Depression of the 1930s. When the stock market crashed, Hoover ordered the government to step in with massive public works spending, prop up wage rates and prices, increase taxes, and lend money to unsound businesses.

He called in many top industrialists in the country and bludgeoned them with so-called "voluntarism". In effect, he said, "Keep wage rates up, and continue construction voluntarily, or I'll get Congress to force you to do it." The industrialists agreed to do it, and for the first time in the history of the world, real wage rates went up in a depression.

The result, of course, was prolonged and very severe unemployment. If the government allows wage rates to fall, so will unemployment. But if the government insists on higher wage rates, then there will be more unemployment. And that's exactly what resulted from Hoover's policy of intervention.

As these government policies took us deeper into the depression, the government only intervened further. By the time Hoover left office in 1933, production had fallen 50%. Unemployment reached an unprecedented 25% of the labor force.

The capital goods industries, which had been the first to profit from the inflationary boom before 1929, were the hardest hit by the depression. Business construction fell 84%. Factory employment dropped 42%. Pig iron production decreased 85%. The value of construction contracts fell 90%. Industrial stock prices declined 76%.

PCCE: What effect did Roosevelt have?

ROTHBARD: When Roosevelt took office in 1933, he tremendously expanded Hoover's interventionist "New Deal" policies. The result was the longest and most severe depression in American history.

In all previous depressions, the price level fell. The banks had to contract credit to stay afloat. This brought about a decline in the money supply which led to a general drop in prices. For example, from 1929 to 1933, there was a general drop in prices. Yet, from 1933 to 1937, even though we had a deep depression, prices were going up.

INFLATIONARY RECESSIONS
PCCE: Why were prices going up?

ROTHBARD: In every depression until the Great Depression of the 1930s, the shift of resources from capital goods to consumer goods caused capital goods prices to fall much more rapidly than retail prices. During 1933 to 1937, however, Roosevelt was inflating the money supply, so the price level could not drop.

Since the price level couldn't drop, the shift from capital goods to consumer goods caused consumer goods prices to go up faster than capital goods prices. This means the cost of living went up — we had a simultaneous depression and inflation.

This happened again in 1969 when the Nixon administration attempted to cut back accelerating (continued on page 3)
inflation by tightening credit. The result was a necessary recession in the capital goods industries. As the recession set in, the administration panicked and around February 1970, they turned the money tap on again.

But once a recession takes hold, it's not easy to get out of it. When the Federal Reserve pushed interest rates down again, it increased inflation, but the capital goods industries were still in a recession. This is why we had an inflationary recession up until this year.

Nowadays, a fall in the money supply is considered unthinkable by economists and politicians. As a result we may never again have an actual fall in the price level. Instead we now have both recession and increases in the cost of living at the same time. The consumer gets it in the neck both ways.

The government should not try to prop prices up; not try to keep wage rates up; not try to shore up unsound businesses. It should allow the liquidation process — the necessary market adjustment — to take place. Then the recession or depression is over with quickly, instead of lingering on and on as in the Great Depression.

When we finally got out of the Great Depression, it was despite the New Deal rather than because of it. We got out of it by World War II. We had 10 million unemployed, and then 10 million men went into the army. That eliminated unemployment.

HOW WAGE AND PRICE CONTROLS LEAD TO SHORTAGES, RATIONING AND BANKRUPTCIES

PCCE: Back in the '30s, the government tried to end the depression by keeping wages and prices up — with the harmful results you just mentioned. Today, the government is trying to stop inflation by keeping wages and prices down —

ROTHBARD: Price controls cannot stop inflation. Price controls can only make things worse.

The way they work is very simple. Let's say the price of Wheaties is 15c a box, and for some crazy reason the government orders that there can be no Wheaties sales above 5c a box. You can bet very few people would keep producing Wheaties. But lots of people would clamor to buy them because Wheaties would be a big bargain at a nickel a box. The end result would be an enormous shortage in Wheaties — an excess of demand over supply. Nobody could find Wheaties anywhere. Then you'd have a black market in Wheaties with "hot" Wheaties sold on the street corner to passersby.

Price controls fool a lot of people because the day price controls are imposed, nothing seems to change. This is because the price control inevitably freezes prices at the existing level, which is somewhere around the free market price. The next day's equilibrium is about the same too, so nothing much is going to happen at first.

It takes some months for the distortions to pile up. Then as time goes on, there will be more and more distortions. Shortages, black markets, and rationing will develop gradually — then accelerate.

PCCE: Why do many businessmen support wage and price controls?

ROTHBARD: One reason is many businessmen believe wage controls will be more effective than price controls. Therefore wage rates will be kept down. They think this is to their advantage.

But just as price controls below the free market price bring about shortages, so wage controls below the free market rates bring about labor shortages. And labor shortages have some very unfortunate effects.

For example, suppose Firm A is paying a worker $10,000 a year, and a competing firm, Firm B, is paying $12,000. The worker at Firm A naturally has an incentive to shift to Firm B. The only way that Firm A can keep him from leaving is to raise his salary to $12,000.

But all of a sudden the government freezes wages. They tell Firm A, "You can't raise the guy's wages."

The result is that many firms lose their best employees. This leads to increasing bankruptcies, especially among the firms that were just about to raise wages, but were prevented from doing it by the freeze.

So either you have increasing bankruptcies, or many workers will be forced to remain on their jobs for the duration of the inflation emergency. This may sound far out, since it's a form of slavery, but it's very realistic.

PCCE: Has this happened before?
ROTHBARD: Yes. For 3 years after World War II, the American Army of Occupation imposed a severe system of wage and price controls on the German economy. It was done deliberately to smash the German industrial economy — to suppress, cripple, and punish them.

The result was severe shortages of necessary products, along with a severe labor shortage. Labor was then rationed in Germany so that no German worker could get a job except through the American Army Labor Exchange. The American Army told German workers where to work. They said, "all right, we'll assign you to a Hamburg steel plant." If the fellow didn't want to work in a Hamburg steel plant, then he couldn't work at all.

This is the logical conclusion of rigidly enforced wage controls, and we'll see it here if this keeps up.

PROFIT CONTROLS

PCCE: How about profit controls?

ROTHBARD: They're horrendous. With profit controls, if you make high profits you are forced to lower your prices, and if you make low profits you can raise your prices or keep them the same.

Any imbecile should be able to recognize their consequences. Business firms will lose their profit incentive. Businesses making high profits realize the Price Commission will force them to lower their prices, so they'll just find ways of not making profits. Profit controls give businesses a direct incentive to be inefficient, instead of being efficient, as they would be in a free market.

HOW THE NATIONAL DEBT HARMS THE ECONOMY AND DAMPENS STOCK PRICES

PCCE: Turning to another current problem, Professor Rothbard: the national debt is now about $450 billion. That's more than ten times what it was before the Great Depression. This year's budget deficit is going to hit $35 billion, and many economists are now saying that the budget can't be balanced in the foreseeable future. What effect is this going to have on the economy?

ROTHBARD: In the first place, the interest on the national debt will go higher. During the 1930s and '40s, we heard from Keynesian economists that it doesn't matter what the national debt is, "Because we all owe it to ourselves."

But we don't owe it to ourselves. Some of us owe it to others of us, and it has to be paid for through taxes. The tax burden, of course, is a big drag on the productive system, so the national debt becomes an evergrowing burden.

Second, deficit spending usually is financed through bank credit expansions. So it inflates the money supply, which is now going up 8 to 10% a year. This is a very, very high rate and will cause greater inflation next year than we have now.

A third unfortunate consequence of the national debt is its effect on the stock market. The Treasury sells bonds in the bond market to finance its increasing deficits. This pushes up interest rates. As inflation proceeds, and as the Treasury has to finance more bonds, interest rates keep going up.

This increase in interest rates means there's pressure on the bond market, and a damper on the stock market.

PCCE: Would you clarify this please? On one hand, we have inflation which, according to theory, should drive bond prices up and interest rates down. Yet the interest rates are going up.

ROTHBARD: Well, what happens is, initially, credit expansion pushes down interest rates below the free market level. However, as inflation picks up momentum, as prices start going up, interest rates go up to offset this increase in prices.

For instance, if the interest rate is 6%, and prices go up 6%, we essentially have a zero interest rate. This wipes out the creditor's gain because the money he gets back is now worth 6% less.

As a result, creditors will raise interest rates to compensate for the price increase. So as the inflation takes hold and really gets going, and people realize it's going to continue — interest rates inevitably go up.

HOW RUNAWAY INFLATION AIDED THE COMMUNIST CONQUEST OF CHINA

"Perhaps the major reason for the fall of China was that Chiang Kai-Shek had generated a tremendous runaway inflation. Chinese currency and prices were increasing astronomically.

"In an attempt to halt inflation, Chiang instituted harsh wage and price controls. Severe shortages resulted. Peasants couldn't get clothing. People in urban areas couldn't get food. There was total chaos.

"To enforce his wage and price controls Chiang initiated fines for violators. When this didn't work, fines were doubled. Then jail sentences were imposed. In the end Chiang decreed the death penalty for all people who sold above the ceiling price. He held public executions in the Square of Shanghai, machine-gunning many merchants.

"Because of this, it was a much easier task for the Communists to take over Mainland China."

"Therein lies a lesson for us all."

(continued on page 5)
DON'T BE FooLED by the government's advertisement for 2.3 million Carson City uncirculated silver dollars. The government is asking a minimum of $30 per coin and claims "they are sound investments."

However, the influx of these 2.3 million silver dollars will probably drive their market price below the $30 minimum offering price. Indeed, coin dealer Deane Jones predicts that after the coins are sold, the price will drop to between $15 and $24. And Harvey Stack of Stack's of New York City, perhaps the largest numismatic dealer in the nation, says "if [the government's] advertisement was circulated by a private firm [the Security and Exchange Commission] would start an immediate action for 'cease and desist'."

It's one of the big reasons why increased profits and inflation don't necessarily raise stock prices. The interest rate offsets it.

BALANCE OF PAYMENTS DEFICITS

PCCE: In addition to the domestic problems you've been describing, America has had chronic balance of payments deficits for the last 10 years — and it's getting worse. What causes them, and what is their consequence?

ROTHBARD: The basic reason for our balance of payments deficits is the American monetary inflation. This raises prices and makes American goods less competitive in the world market.

Basically, the dollar is now the foundation of all credit — and we've been inflating the dollar for more than 30 years. As a result, gold started flowing out because of the balance of payments deficit.

As gold flowed out, the American dollar became shakier and shakier. We had to keep persuading, inducing, and coercing other countries to pile up dollars and not redeem them in gold.

INTERNATIONAL TRADE WARS AND DEPRESSION

PCCE: How did we prevent foreign countries from cashing in their dollars?

ROTHBARD: By all sorts of methods. Our expansionist foreign policy, for example, gave us leverage. We threatened to withhold aid if the other countries redeemed their dollars for gold. But as they kept piling up more and more dollars, and as our gold supply grew smaller and smaller, these foreign countries got edgier and edgier.

Eventually, on that black day of August 15, 1971, the Nixon administration was forced to repudiate the dollar and declare a national bankruptcy. When the United States did this it was saying, in effect, "Even though we had declared our obligation to redeem our dollars in gold, we are no longer going to do it, period." "We closed the gold window" is the polite way of saying it.

This has now plunged us into a system like the 1930s. But this is worse, because at least in the 30s the dollar was still redeemable in gold. Now, with a completely fiat system, anything could happen. We'll have a harsher system of currency blocs, competitive devaluations, and economic warfare.

We might have a dollar bloc, a sterling bloc, a gold bloc in Western Europe — and maybe even an Asian bloc of some sort.

West Germany, Switzerland, Britain, France, etc., rely very much on international trade. If we have a breakdown of international trade and international investment, due to currency blocs, devaluations, tariff blocs, etc., these countries would suffer a severe depression — no question about that. Severe depression in these countries will result in depression at least in American export industries.

WORLD-WIDE RUNAWAY INFLATION

PCCE: Western Europe seems to be taking very definite steps toward an International monetary union based on gold. Do you think there is any chance they can accomplish their aim?

ROTHBARD: Almost none. The entire United States establishment, both Democratic and Republican, stands almost hysterically opposed to gold.

The United States, being an inflationary country, wants to get rid of gold altogether. The reason the government hasn't been able to do this so far is because the hard-money, Western European countries are totally against it.

SILVER PRICE TO "SKYROCKET"

Predicts Charles R. Stahl

In the most recent issue of Green's Commodity Market Comments, Charles R. Stahl, Publisher, notes that:

"... by the end of 1972 total silver stocks in England should have declined by approximately 87.4 million oz. from their 1971 total ... [and England's] silver stocks will be fully exhausted next year.

"Since the United States has a gap between consumption and production of silver which this year will amount to more than 100 million oz., and since there is a gap between consumption and production of silver in the rest of the world as well, nothing can prevent the skyrocketing of the silver price, except if some miracle substitute should be found forthwith. Since that is not very likely, we assume that our projected price of $2.50 for spot silver during 1973 will be exceeded by far."
What the United States would like is a World Central Bank, controlled by the United States, with a new paper currency. Then, if we have a balance of payments deficit, instead of having to pay up in gold we can pay up in Special Drawing Rights (SDRs).

So far, SDRs have been very limited. We have only a few billion of them. But with the American objective of a World Central Bank, controlled by us, issuing SDRs at will, we can simply have SDRs issued to pay our debts. We could then go merrily on our way, inflating forever, so long as we have control over the World Central Bank.

This means we'd be coordinating inflation on a world-wide scale. We could leap over the balance of payments constraint, but the result would be an eventual world-wide runaway inflation that would create chaos.

PCCE: If we should ever have runaway inflation, can commerce continue?

ROTHBARD: Well, trade continues but starts cracking up and collapsing. Runaway inflation is much worse than a depression. It's sort of like a super-depression combined with inflation.

WHAT LIES AHEAD

PCCE: So we in America are facing accelerating inflation. We have wage and price controls. We face an enormous, rapidly-growing national debt. We face the probability of trade wars. World-wide runaway inflation is a possibility. Where does all this end?

ROTHBARD: It ends rather badly I would say. Increasing inflation next year is almost certain. But the exact moment trade wars, runaway inflation, or depression may strike is hard to know.

HOW TO PROTECT YOUR ASSETS

PCCE: How can we protect our assets against depression and runaway inflation?

ROTHBARD: Well, of course it's very difficult. In general, stocks are pretty bad investments because we have high interest rates that keep a damper on stock prices. And the value of government savings bonds has been half wiped out by inflation already. The poor people who bought savings bonds in World War II bought them at low interest rates. As prices went up, their capital got wiped out.

The classical method — and I would say the best method — to protect yourself against runaway inflation or depression is with durable, highly-valued commodities like jewelry, paintings, gold, and silver.

I see a great future for gold and silver coins as the currency people may increasingly turn to when paper currencies begin to disintegrate.

PCCE: If you wanted to hedge against a possible runaway inflation, or a possible depression, would now be a good time to buy gold and silver coins?

ROTHBARD: Absolutely.

Gold & silver news briefs

SILVER PRICES SET 3 YEAR HIGHS

- The price of silver recently went up more than 16c in less than 2 weeks. The year's previous high of $1.91 per ounce was easily topped as silver went over $2.00.
- The Franklin Mint reports record sales for the third quarter of 1972 — up 26% from the same period last year. Earnings set record highs too.
- A silver suspension paste is being used in a new electrical heating device that defrosts rear windshields of cars. It's expected to be standard in all new cars by 1974.
- The Bureau of Mines reports silver consumption for the first 9 months of 1972 up 11.1% over the same period of last year. 103 million ounces were consumed.
- Jules Chenier of Chender Associates said he wouldn't be surprised if the Soviet Union begins importing silver soon. This would be a major bullish development for the price of silver.

- The Sunshine Mine, forced to close in May because of fire, will reopen gradually as mine inspectors declare sections of the mine safe.
- The Bureau of Mines reports U.S. silver mine production for the first 9 months of 1972 down 2% over the same period last year.
- The Comex silver supplies down again this month. They now stand at 81 million ounces — 15 million less than in August.
- B. L. Wilcox of American Smelting & Refining expects mine production to grow no more than 3% per year. He predicts the price of silver will double within a few years.

GOLD

- Paul Henshaw, President of Homestake Mining which is North America's largest gold mine, says $60 an ounce for gold is not enough to justify reopening shut down mines.
- Canadian gold production down 8% in the first 8 months of 1972 vs.