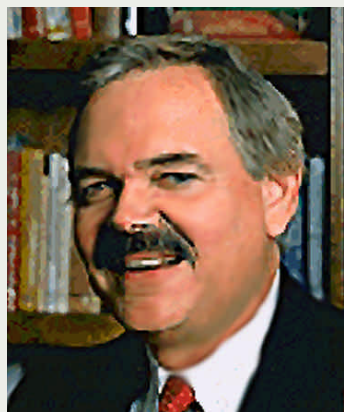


AUSTRIAN ECONOMICS

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Morgan O. Reynolds (Ph.D., University of Wisconsin, 1971) was chief economist at the U.S. Department of Labor, 2001–2002. He was on leave from Texas A&M University, from which he recently retired as a professor of economics.

He is the author of *Power and Privilege: Labor Unions in America* (1984), *Economics of Labor* (1995), and *Making America Poorer* (1987), and more than 60 articles in scholarly journals.

He is an adjunct scholar of the Mises Institute, Mises lecturer at the Austrian Scholars Conference 8, and a senior fellow of the National Center for Policy Analysis based in Dallas, Texas.

An Interview with Morgan O. Reynolds

LABOR AND THE AUSTRIAN SCHOOL

AEN: What was it like to go from theory to practice so suddenly?

REYNOLDS: Highly educational. I went from a professor of economics, with a career-long specialization in labor, to chief economist at the Department of Labor. I was in this position for 16 months. The position came about because of an old contact. I'm glad I did it, but my experience confirmed everything that the Austrian School and the Public Choice School say about how government behaves.

On my first week of the job, I was confronted with “numbers day.” This is when the secretary of labor has to comment to the business press about the new monthly employment and unemployment figures issued by the department’s Bureau of Labor Statistics. I was the technical adviser, meaning that I had to explain what the numbers were and how they fit into the economy’s recent performance.

I prepared short memos on the economy separated into “good news and bad news.” The secretary chose the good news and when an interviewer pointed out bad news, she urged Congress to pass the administration’s latest economic plan.

I was immediately struck by two things. First, the government believes it has to maintain public confidence in the economy in order to build and sustain prosperity. This not only reflects a degree of economic ignorance but also means that all news must be spun as good

news, even when it is not. It reflects the desire to encourage docility, which makes the population easier to subjugate.

Second, as Ronald Reagan said, politics is just like show business, and truly, I was struck by the glitz of the whole enterprise at that level. I remember getting into the secretary's black sedan to tape an interview at the Fox News Channel with Neil Cavuto, and thinking just how much

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like Hollywood D.C. really is. The difference was that we were told not to call these cars limos but "sedans."

AEN: Had you been able to give honest advice, what would it have been?

REYNOLDS: I always believed that the Bush administration should have been frank about the boom and bust. We should have just said, look, the boom is over and Clinton left us with an economic contraction. Bush could have said that once the Greenspan-Clinton recession ended, recovery would begin. And it would have. We would probably have real economic recovery instead of the sick patient we have today. But early on the administration got scared out of "talking the economy down."

Because the economy is loose jointed, the Fed and the rest of the government apparatus have managed to make this recession look mild. It would have been better to allow liquidations. The consumers' balance sheet is in sad shape, capital expenditures are not going to come on stream, and we are generally in a perilous condition.

Reagan fortuitously enjoyed a very severe recession early in his first term, and it was followed by an economic recovery. But the Bush administration was loath to allow the recession to happen and kept imposing policies designed to end it but that actually end up prolonging it. Reagan was handily reelected. We'll see about Bush. In any case, even from a narrow political point of view, I believe that the Bush administration misplayed its cards.

AEN: You had called the agency for which you worked the Department of Organized Labor.

REYNOLDS: My impression has to be modified by my experience. Because employers are so important and the business community is so important, and any change in regulation affects their interests so profoundly, the role of organized labor is counter-weighted by them. Certainly, business associations have as much influence as the unions. Also, there is an ideology there that it is the worker in general, not just the union member, who deserves protection. The labor unions do not have *carte blanche*. But like any cabinet agency, the department includes many subagencies, like OSHA, that advance union interests.

AEN: Did anyone suggest that your appointment would be politically dangerous for the administration?

REYNOLDS: When I was interviewing, I was very clear about who I am and what I believe. I thought, "Wow, if the Bush administration is willing to appoint me, maybe we can do something." But my position did not require Congressional approval. Nor did they advertise me in the way you would an assistant secretary. Economists just don't have that kind of visibility. I was never attacked by the press, but, on the other hand, the administration didn't let me out that much. I only made two public speeches while I was there. Another cost of these jobs is that you cannot write for the public. I missed that.

AEN: Were you there when unemployment benefits were extended?

REYNOLDS: Yes, and this experience was a reminder that Republicans don't have a whole lot of moral or intellectual courage. They took the usual route of expanding benefits for 13 weeks instead of the usual 26 weeks that the Democrats were pushing. When this was in contention, the secretary would always deflect the question, and sometimes she would say the right thing: that it is better to get a paycheck than an unemployment check.

I remember having lunch with Glen Hubbard, who was then the chairman of the Council of Economic Advisers. He said, oh yes, the president understands that enriched unemployment benefits will yield a 0.2 percentage point increase in unemployment. He admitted that you only aggravate the problem by discouraging wages from moderating so that people can price themselves back into employment. But in the end, the Bush administration did exactly what you would expect: it renewed the benefits not once but twice.

But this goes back to what Austrians have long said: you can't make much of a difference from within government. The change in policy must come from the outside, through intellectual work and public education.

AEN: Unemployment benefits have been a huge menace to economic recovery in certain times and places.

REYNOLDS: Oh, certainly. In the 1920s, unemployment benefits nearly destroyed the entire British economy, and later led to the appearance that the Keynesian theory was being

validated. In the U.S., we are nowhere near that situation.

In fact, our system is relatively ungenerous by world standards. In Germany, the government is talking about cutting unemployment benefits down to one year. Elsewhere in the EU, benefits can be extended to five years. One of the better things about the U.S. system is that it is state run, and the states do a much better job than the feds ever would. People have commented to me that we in the U.S. have no idea how bad it can get.

AEN: Talk about 9-11 a bit. The attacks occurred a week after you got there.

REYNOLDS: I remember the day very vividly. It was only one week after my arrival. I talked to one of my sons that day, and he commented that I sounded rattled. I certainly was. Everyone in the area came to the realization that we were all vulnerable. It made a very big impression on everyone. All the added security at government buildings only enhances the sense of being vulnerable. Ever since that day, there has been a constant wartime atmosphere.

AEN: How did 9-11 affect the priorities of the administration?

REYNOLDS: Spending went out of control. The *Washington Post* has pointed out that the current rate of spending has not been seen since the Great Society. The whole war emergency, as Robert Higgs writes, has worked as a pretext for ratcheting up government. It didn't really affect the Labor Department as such, but the department did enjoy some of the

new largesse. When I got there, the budget was \$44 billion annually, and when I left it was \$59 billion. The biggest beneficiary was the Employment Training Administration, a lot of which also had to do with the recession.

The secretary of labor once asked us, "If we were a Fortune 500 company, where would we be ranked?" Of course there is a huge difference between the coerced spending of

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government and voluntarily raised money associated with markets. That aside, it turned out that we ranked with the 28th largest corporation. She never did anything with the figure, but it was clear that she was concerned that we were not looking too good in terms of checking the growth of government.

AEN: Nearly everyone had a different vision of what the Bush

administration would be like than what has come about.

REYNOLDS: It leads to voter cynicism. Clinton had all sorts of plans for big government, but in retrospect, his spending increases weren't that bad. Of course, we had a divided government, which is the best thing to have if you want to restrict government expansion. The Congress and the bond market worked to keep Clinton's spending in check. Meanwhile,

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Bush said that he was against nation building, and look at where we are with Iraq!

It really angers me with Republicans in particular, who talk good free-enterprise rhetoric on the stump but when they get there, the reality is completely different. It almost leads one to vote socialist in order to get fewer socialist policies.

AEN: What are you thinking about working on now that you have left government?

REYNOLDS: Long term, I'm interested in doing work on Say's Law as the very heart of understanding macroeconomic performance. I have written an article on the topic but it really should be a book. An embrace of Say's Law is something that unites the classical and Austrian traditions, but the whole subject needs more work. Say's Law says that in order to demand, you have to supply. It means that production is the basis of economic growth. But Say's Law also needs to be considered in light of several features of modern economic life, including fiat money and fractional-reserve banking.

It is a great tragedy that Keynes's critique of Say, which was clever but not wise, seems to have stuck. We are seeing this now, with all these attempts to shore up demand in order to keep boom going even though we are so clearly living beyond our means. I was struck in D.C. that this kind of bad economics completely dominates. The belief that spending drives the economy dominates Wall Street and the business press. There is virtually no appreciation of the role of production, to say nothing of Austrian business cycle theory.

AEN: How is it possible that anyone could overlook the reality that contraction is a response to the previous boom?

REYNOLDS: I don't know, but it is widely thought that we can have one of the largest financial bubbles in the history of the world and get away

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with the mildest contraction since World War II. This is crazy. Pain deferred is not pain avoided. In fact, it is pain cubed. Actually, I'm expecting that in 20 years, the Austrian theory will be dominant, if only because it is the only one out there that makes sense of the real world.

In the meantime, people can manufacture a hundred reasons for the tepid recovery. The claim is that because of some sector-specific shocks, stocks lost some altitude and that, in turn, dragged others down. Then it spun out of control. Another view is that uncertainty about the election in 2000 led consumers and investors to be skittish and that caused problems. Then there's the great 9-11 excuse, the war, the reconstruction, and on it goes.

AEN: So it is attributed to an exogenous shock of some sort.

REYNOLDS: Yes, and each of these has an economic impact, but not enough to account for the full length of the contraction. Some of the problem is that people think that asset prices can somehow be separated from real economic phenomena. That is a separation theorem that cannot withstand critical examination. But a lot of people believe what they want to believe.

In the equity market, someday we are going to have a panic, in which people are just going to throw in the towel and say they won't take it anymore. There's already a lot of pain out there, and there is more coming.

AEN: It does seem that in the private sector, unions are less and less of a problem.

REYNOLDS: The most recent survey by the Bureau of Labor Statistics shows that reported union membership in 2001 in the private sector was 8.5 percent of nonsupervisory jobs versus 37.5 percent in the public sector. Membership continues to erode and we're now down into the single digits. In the early 1950s, it peaked in the private sector at 35 percent.

To the extent that there is freedom in the marketplace, there is a tendency for unionism to erode, barring concerted efforts to sustain it. We are seeing that in the airlines today. How can you survive in a highly competitive industry as a unionized company with all these high costs? We are seeing that you cannot. More and more workers are gravitating toward the nonunion firms because that's where the jobs are. It's an invisible-hand kind of process at work.

Misesians often talk about the middle way between socialism and capitalism, how it usually tends in the direction of socialism. But when it comes to unions, the pressure is running the other way, more and more toward market control and away from government-union control. All the recent campaigns for higher union memberships are just dishonest PR. They give the impression that unions are nothing but voluntary clubs. It's not true. Most employees today want nothing to do with them.

Still, unions have their niches of organized power: script writers in Hollywood, musicians in New York, and in the transportation sector. Here they continue to cause periodic problems for the industry and the workers alike. The automobile industry continues to be shaken up,

with nonunion plants far outcompeting unionized ones.

AEN: Why did you decide to leave academia?

REYNOLDS: I was disappointed at the direction of change. In the early '70s, Texas A&M had very good free-market economists. We were known as a "Chicago farm club," meaning part of the Chicago tradition in economics. To see us go from that level

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of excitement and excellence, to become just another department attempting to be a mediocre MIT, was quite disappointing.

Of course I was involved in the debate about our future, but the path is familiar. The new dean wanted to promote a nonideological approach, which always amounts to becoming like everyone else. I've never understood this. You would think economists would know something about finding a market niche.

AEN: Talk about your training in graduate school at the University of Wisconsin, and how you came to be so close to the Austrian tradition.

REYNOLDS: Wisconsin was a geographic choice more than anything else. The department had always been left-liberal but in the 1960s it was transitioning into a modern department with more diversity. In graduate school, I began with a soft-left ideology. My first influence in

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the long transition to appreciating the market process was Gary Becker, then Milton Friedman. At my first job at the University of California at Riverside, I used to argue with a student of Armen Alchian's, and he would win every argument. I finally decided that if I can't win arguments, there must be something wrong.

Later I discovered William Hutt, and finally Ludwig von Mises. Mises

ended up being the most influential thinker in my Austrian turn. For some it is Hayek, others it is Rothbard, but for me it was Mises. So I came to the Austrian tradition as a fully formed economist, highly sympathetic to free markets, and it was Mises who took me the rest of the way. It was a process. That's the great thing about being a professor. It's a privileged position, in that you can think and read and write even as you are always learning. We are just older students.

In terms of books, I taught a class on the history of economic thought and I used *Human Action*. We used some Hayek. We also read Eugen von Böhm-Bawerk's three-volume work on capital and interest. We also read Wieser. That was a great seminar. But I concluded that of everything we read, and I've learned from many of them, including Rothbard, Mises was the best.

AEN: Could you talk a bit more about William Hutt?

REYNOLDS: I met him sometime in the late 1970s. Eventually, I came to do an interview with him that was published in the *Journal of Labor Research*, and I edited a *festschrift* in his honor. He was a man of great courage. I remember when he came to Texas A&M to see a debate we sponsored between Paul Samuelson and Milton Friedman. Hutt was usually ebullient, but this time he came to my office and he was in a down mood. He said that he hadn't influenced anybody. I pointed out that he had influenced me! That seemed to cheer him up. It shows that everyone has mood swings.

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AEN: What about his economic thought?

REYNOLDS: I don't believe he can really be called an Austrian, though Mises really liked him. Hutt at his best is great. But he has his flaws. He once endorsed estate redistribution. He had some World War II planning missteps. Some of his older writings are wrongheaded. But when I knew him in the 1980s, he was as sound as anybody. His works on Keynesian theory, labor unions, and Say's Law are absolutely wonderful. I became a real advocate of Huttian economics.

Hutt is widely credited with coining the term "consumer sovereignty," though this is somewhat contested. It is useful but it has created some confusion. Sovereignty is a political term that implies dominance, and that is not what we are talking about. If we think of this term as a metaphor for the ultimate end of the production process, it is a useful and clarifying term. To this extent, it is only a way of amplifying an aspect of Say's Law. But if you look at it as a normative policy idea, it creates problems because it leads to the idea that consumer interests ought to trump everything else. It is a concept that has to be handled with care.

AEN: How do you as a libertarian regard Hutt's claim that unions are inherently coercive, even when they do not enjoy government privileges?

REYNOLDS: Yes, Hutt is right, but let me qualify that. When Hutt is talking about labor unions, he is talking about the Anglo-American-style unions, which are inherently coercive because they erect barriers to entry that require legal immunities and

privileges. Just look at the language of unions and how it is drawn from the military. They threaten to strike, create picket lines you can't cross, retaliate against scabs, and all the rest. Their power to raise wages rests on their power to restrict entry into the labor market, which they can only do through coercive means. The police, who are often union members, must turn a blind eye to their violence.

One might imagine noncoercive collective action, though it is a little bit hard to conceive, like a virgin birth. The examples we saw in the U.S. are company unions, in which both the owners or managers participate along with workers. It was a great institution and market tool but those types of organizations were banned by the Wagner Act in 1935. This was a result of lobbying pressure. The large, aggressive unions didn't want these around because workers often chose these arrangements over today's unions. We might also imagine many intermediate forms of representation that are nonviolent. But what we call unions today are inherently coercive, yes. They would not exist in a free market.

AEN: Do you think Austrians have anything unique to contribute to labor economics apart from the usual free-market insights?

REYNOLDS: There is nothing unique that applies only to labor, but the Austrian appreciation of the way markets work, and the way we should study economics, affects the way we look at all fields, including labor. Taking a subjectivist and a deductive view of economics inoculates the economist against a lot of

what passes for analysis in the labor-economic mainstream. Labor economics has become virtually a branch of applied econometrics, with the usual large data sets and headless horsemen running around looking for patterns. It's all about estimating parameters and other monkey business. All of this forgets that the human being is not an effect but a cause.

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One of the great things that one learns from the Austrians is that there is not a separate mode of analysis or theory that applies to different fields in a way that is somehow unique to that field. You can't look at one sector without considering the way in which it is linked to every other sector.

AEN: You have written on the socialist calculation debate. What are the lessons still unlearned?

REYNOLDS: The main lesson that Mises taught is still neglected. He argued that in the absence of effective private-property rights and exchange with money, there would be no market prices. In the absence of money prices, you cannot calculate profit and loss. There are no substitutes for prices and profit and loss, and so without them, we are confronted with a world without economizing, that is, a world of chaos. Even if we know what we want to do, we cannot find the least-cost method of doing it.

That's the lesson. But when I presented this paper at the university, I had the longest and most intense debate with two colleagues about it. They are two very smart guys. But I could not convince them, no matter

what I said. They kept claiming that they could find a big enough computer and nonlinear programming model, and proceed to map that n-dimensional frontier and eventually take care of the problem.

I pressed them even on the subject of changes: let's say people are being born and are dying, preferences are changing, resource availability shifts, and on and on. But they stuck to their claim that we are smart enough to manufacture a substitute for the free market. This is just absurd. It is ludicrous. But the claim is still made.

They weren't socialists; they just believed that you don't need markets for economizing in a complex economy. They are typical mainstream economists who do not recognize the

limits of the human mind. Part of the problem may be that economists are very bright. They believe that there is nothing they can't figure out.

AEN: You have been in academia, in government, and even in public affairs. Which direction do you think Austrians ought to gravitate? Which direction offers the greatest hope for change?

REYNOLDS: The main thing is to just keep showing up. Among the young, who are the future, we have great promise. We have a differentiated product that is very attractive, and we are greatly helped by the aridity of mainstream economics. The truth is powerful and attractive. People do want to hear it. **AEN**

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