

The

FREEMarket

PUBLISHED 12 TIMES PER YEAR BY THE LUDWIG VON MISES INSTITUTE

Is the Downturn Over?

Robert P. Murphy

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Some days, it's embarrassing to be a professional economist. On Monday, the National Bureau of Economic Research (NBER) officially declared that our recession had ended—15 months ago. Yes, that's right, just as more and more analysts are worried about the economy imploding again, the NBER announces that the recession ended back in June 2009. The whole episode underscores the crudity of mainstream economics.

NBER said: "The committee decided that any future downturn of the economy would be a new recession and not a continuation of the recession that began in December 2007. The basis for this decision was the length and strength of the recovery to date."

If nothing else, the NBER's announcement should give serious pause to those who chastise the Austrians for their "unscientific" approach to economics. Ludwig von Mises famously argued that the economist should proceed by logical deduction, rather than by aping the method of the physicists.

Naturally, many mainstream economists mocked Mises for these ostensibly Neanderthal views; Paul Samuelson wrote, "I tremble for the reputation of my subject." It's funny, because I have a similar reaction to the opinion from our macroeconomic wizards at the NBER.

Just stop and think about what has happened: According to the NBER, the US economy went through a severe recession from December 2007 to June 2009. Now it took the NBER until December 1, 2008, to announce that the economy was *in* a recession—a full year after it began (according to the same NBER). And then, with this week's announcement, the NBER announced that the economy had exited the recession, a full 15 months after the fact.

The NBER Business Cycle Dating Committee is composed of some pretty prestigious names. I certainly am not suggesting that these guys are a bunch of idiots.

Rather, I am pointing out the virtual uselessness of the empirical approach when it comes to "fine-tuning" the macroeconomy. Even if we had reason to believe that ⇨

government policies could overcome the failings of the free market, such interventions would be as hopeless as those of an Earth surgeon operating on a Martian patient with a remote-controlled scalpel. The information lag would be enormous.

The problem isn't simply one of delayed information. The very approach of mainstream macroeconomics—with its focus on aggregates such as “Gross Domestic Product” and “Gross Domestic Income”—is misguided, and tends to support the same interventionist policies that prolong crises.

For example, most readers probably think that the US economy was in a bad way throughout the 1930s. After all, people refer to this period as “the Great Depression.” And sure enough, from 1931 to 1940, the official annual unemployment rate never dropped *below* 14.3 percent. So the average American would no doubt have felt as if the economy were really awful for this entire period.

And yet, if you go to the NBER's chronology of business cycles, you'll see that “the Great Depression” is apparently a misnomer. There was a recession from August 1929 through March 1933, and then another (short) one from May 1937 through June 1938.

In particular, the NBER says the US economy was in a recovery from March 1933 through May 1937, even though the annual unemployment rates for the intervening three years were 21.7 percent, 20.1 percent, and

17.0 percent. That's a rather anemic recovery, wouldn't you say?

Let's say you are running and then break a leg. You have to crawl now, but you develop that skill and are able to get from here to there. Are you in recovery from the accident? According to the NBER, yes—so long as you are crawling faster than when you first hit the ground in agony.

The problem isn't simply one of technical economic definitions differing from those of the layperson. No, the problem is that the reliance on (fairly ambiguous) aggregates gives false credit to harmful policies. For example, what happened in March 1933 that “ended” the awful recession under Herbert Hoover? Why, that was the exact month that FDR was inaugurated.

Among other things, when FDR came into office he immediately declared a “bank holiday” and—oh yes—seized everybody's gold. By taking the United States off the gold standard, he gave the Fed the green light to deliver a quick burst of monetary inflation followed by a more general expansion.

Of course, there are plenty of macroeconomists who think that FDR's new policies really did fix the economy, and that it was only Fed tightness (combined with FDR's misguided attempts at budget austerity) that led to a relapse in 1937.

I have dealt with such empirical claims elsewhere. Here I would like to point out that the NBER's techniques

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Editor: Jeffrey A. Tucker

Contributing editors: Thomas J. DiLorenzo, Jeffrey M. Herbener, Robert Higgs, Mark Thornton

Publisher: Douglas E. French

The Free Market is published 12 times a year.

Note: the views expressed in the Free Market are not necessarily those of the Ludwig von Mises Institute.

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implicitly justify big government. For example, suppose the Austrians are right, and that the Fed's massive interventions—coupled with the federal government's absurd “stimulus” programs and other power grabs—at best will postpone the economic correction, and in fact they will make the crash that much worse.

Well, according to the way the NBER works, nobody would ever know this. Instead, “history” will record that Bernanke and Obama did indeed manage to end the awful Great Recession—specifically, in June of 2009—but then something else came along and inexplicably wrecked things. It is an illusion

but one that gets written up as actual history.

The NBER's delayed calls on the start and end of business cycles are fodder for late-night comedians. The average American knew full well the economy was in trouble well before the NBER announced it, and the average American knows full well that our economy is still in serious trouble.

Worse yet, the NBER's approach justifies massive central-bank and government interventions into the economy. The “scientific” approach to macroeconomics will never yield positive results unless the diagnostic technique takes some lessons from Austrian economics. ■ FM

Put on a Happy Face?

Douglas E. French

Doug French is president of the Mises Institute (French@mises.com).

Since two years of zero interest rates, \$800 billion in fiscal stimulus, and the bailout of any business remotely viewed as systemically important haven't resuscitated the dead economy, now the tonic suggested is optimism. American business owners and consumers need to quit getting their daubers down and keep the sunny side up.

George Mason professor of economics Tyler Cowen believes concern over the collective mood is not just for psychologists anymore. Optimism and pessimism are “very relevant to the difficulties that policy makers face: a deficit of optimism has much to do with why the United States economy

remains stalled today,” writes Professor Cowen in the *New York Times*.

So the Fed can huff and puff and make itself triple its pre-crash self, “But if it could just convince Americans that it was committed to monetary expansion and economic growth, it would help the economy pick up speed,” according to the George Mason professor.

Cowen goes on to explain that while the Fed is spewing liquidity, people and businesses just aren't holding up their end of the stimulus bargain.

The common folk out in the real world have increased their demand for liquidity. They are spitting in the face of Fed bureaucrats and college professors who can't figure out why folks

aren't taking advantage of the cheap money, flipping their calendars back to the bubble years, and buying bigger homes, bigger cars, and bigger flat screens.

Brother Bernanke is preaching the way to economic salvation, Cowen claims, but the congregation is unsure of the Fed chair's conviction. Cowen writes, "If no one believes the Fed's commitment to price inflation, spending and employment will not go up. The plan will fail, and people will view their skepticism as vindicated."

The Fed needs to boldly go where no central bank has gone since John Law's Banque Royale, according to top economists. Once more with feeling, the Fed must promise "a credible commitment to a more expansionary monetary policy."

But Professor Cowen has this all backward. The Fed created this mess by slashing interest rates after 9/11 and the bursting of the dot-com stock bubble. The money flowed into all types of real estate. That money and credit created not only redundant brick and mortar malinvestments, but more jobs to build the unneeded subdivisions, shopping centers, and office buildings.

Employment at city halls all over America ballooned to handle vital services like checking plans and issuing permits. Retailers staffed up to handle the hordes of shoppers who used their homes as ATM machines. Dare we say, most everyone was overoptimistic. Not because they took a pill or watched *Dr. Phil*, but because they were spending the cheap and easy credit they thought would never end.

Now the bubble has burst, and those at the Fed and in academia believe rock-bottom interest rates should make entrepreneurs and consumers optimistic again. After all, they plugged low rates into their formulas and it worked—on paper. But it doesn't. Because the crisis, the downturn, is the cleansing of

the malinvestments brought on by the previous blast of monetary expansion.

"Why should hardheaded businessmen, schooled in trying to maximize their profits, suddenly fall victim to such psychological swings?" asks Murray Rothbard in *Man, Economy, and State with Power and Market*. "In fact, the crisis brings bankruptcies regardless of the emotional state of particular entrepreneurs."

Rothbard quotes V. Lewis Bassie, who wrote in "Recent Developments in Short-Term Forecasting," *Studies in Income and Wealth*: "The whole psychological theory of the business cycle appears to be hardly more than an inversion of the real causal sequence. . . . It is not the wave of optimism that makes times good. . . . On the other hand, when the decline comes, it comes not because anyone loses confidence, but because the basic economic forces are changing."

This whole "put on a happy face" theory is hokum. And at least one market analyst, Robert Prechter, believes that optimism still reigns, at least in the investment world. Investors aren't down in the dumps, Prechter writes in his latest *The Elliott Wave Theorist* report. Mutual funds are nearly 97 percent invested and investor sentiment indexes are high.

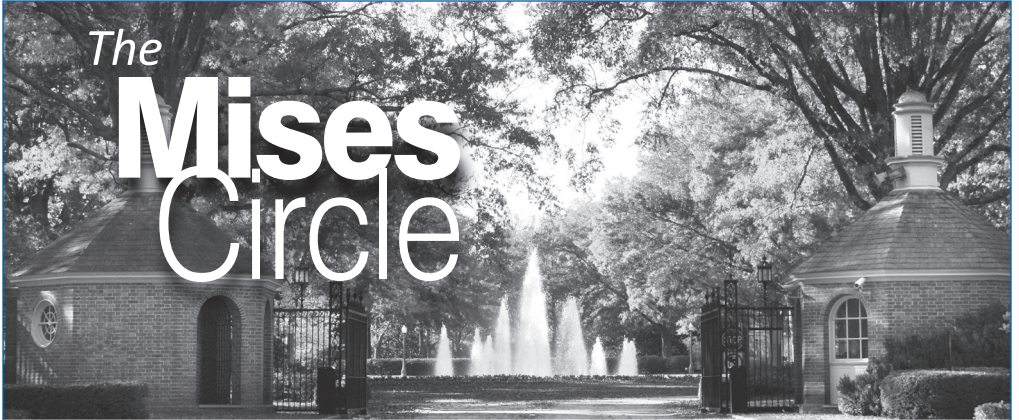
Prechter dissects an article from Bloomberg entitled "Atlanta Awash in Empty Offices Struggles to Recover From Building Binge," listing more than a dozen negative facts about that market referenced in the article. Yet the opinions the reporter found to quote in the article were positive, such as "Owners of troubled properties . . . said they remain optimistic," and "[A] senior vice president . . . said in an e-mail, 'Our outlook is positive'."

A new office tower on Peachtree Street may be 98 percent empty, distressed sales may be nearly half the market, and in-migration has fallen

82 percent in Atlanta, but those in the real-estate business are keeping their rose-colored glasses on. As are Warren Buffett and GE's Jeff Immelt, who claim things are getting better and there is no chance for a double-dip.

As long as the Fed keeps printing and academia keeps rolling out new theories, the cleansing of the

multiple booms created by Fed interventions will continue for years. Those operating in the here and now of the real world have figured out that they should be deleveraging and saving. That may be interpreted by policy makers as doom and gloom, but it's just good sense. ■ FM



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These memos by Murray Rothbard, written in the 1950s and early 1960s, were kept under wraps for fifty years. They were commissioned by the William Volker Fund and concerned most every important thinker and book of the period. Through them, Rothbard provided guidance for the publishing and philanthropic efforts of the Fund itself, which was the main flame for liberty in these dark times.

Rothbard's writing is deeply insightful, brazenly honest, and penetrating in every way, as he treats every subject from strategy to historical scholarship. These memos have never before been published, and they provide a different perspective on the mind of a great and pioneering thinker.

The Volker Fund also asked Rothbard to submit reports on particular questions, such as how to rank sundry economists in terms of friendliness to the free market, surveys of the literature on monopoly, Soviet wage structures, etc. Rothbard's memos number several hundred, covering works in economics, history, philosophy, and political science. The memos, which range in length from one page to seventy pages, provide a window into the scholarship of the period—and Rothbard's views on that scholarship. They thereby shed much light on Rothbard's emerging worldview and his systematic defense of liberty. ■ FM

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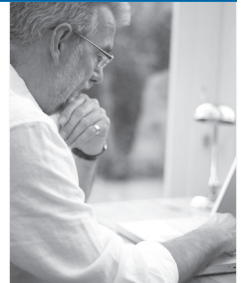
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