INTRODUCTION

In this volume, Murray Rothbard has given us a comprehensive history of money and banking in the United States, from colonial times to World War II, the first to explicitly use the interpretive framework of Austrian monetary theory. But even aside from the explicitly Austrian theoretical framework undergirding the historical narrative, this book does not "look" or "feel" like standard economic histories as they have been written during the past quarter of a century, under the influence of the positivistic "new economic history" or "cliometrics." The focus of this latter approach to economic history, which today completely dominates this field of inquiry, is on the application of high-powered statistical methods to the analysis of quantitative economic data. What profoundly distinguishes Rothbard's approach from the prevailing approach is his insistence upon treating economic quantities and processes as unique and complex historical events. Thus, he employs the laws of economic theory in conjunction with other relevant disciplines to trace each event back to the nonquantifiable values and goals of the particular actors involved. In Rothbard's view, economic laws can be relied upon in interpreting these nonrepeatable historical events because the validity of these laws—or, better yet, their truth—can be established with certainty by praxeology, a science based on the universal experience of human action that is logically anterior to the experience of particular historical episodes.[1] It is in this sense that it can be said that economic theory is an a priori science.

In sharp contrast, the new economic historians view history as a laboratory in which economic theory is continually being tested. The economic quantities observed at different dates in history are treated like the homogeneous empirical data generated by a controlled and repeatable experiment. As such, they are used as evidence in statistical tests of hypotheses regarding the causes of a class of events, such as inflations or financial crises, that are observed to recur in history. The hypothesis that best fits the evidence is then tentatively accepted as providing a valid causal explanation of the class of events in question, pending future testing against new evidence that is constantly emerging out of the unfolding historical process.

One of the pioneers of the new economic history, Douglass C. North, a Nobel Prize-winner in economics, describes its method in the following terms:

> It is impossible to analyze and explain the issues dealt with in economic history without developing initial hypotheses and testing them in the light of available evidence. The initial hypotheses come from the body of economic theory that has evolved in the past 200 years and is being continually tested and refined by empirical inquiry. The statistics provide the precise measurement and empirical evidence by which to test the theory. *The limits of inquiry are dictated by the existence of appropriate theory and evidence*. . . . The evidence is, ideally, statistical data that precisely define and measure the issues to be tested. [2]

[1]For good discussions of praxeology, see Ludwig von Mises, *Human Action: A Treatise on Economics,* Scholar's Edition (Auburn, Ala.: Mises Institute, 1998), pp. 1–71; Murray N. Rothbard, *The Logic of Action I: Method, Money, and the Austrian School* (Cheltenham, U.K.: Edward Elgar, 1997), pp. 28–77; and Hans-Hermann Hoppe, *Economic Science and the Austrian Method* (Auburn, Ala.: Mises Institute, 1995).

[2]Douglass C. North, *Growth and Welfare in the American Past: A New Economic History* (Englewood Cliffs, N.J.: Prentice-Hall, 1966), pp. 1–2 (emphasis in original).

This endeavor of North and others to deliberately extend the positivist program to economic history immediately confronts two problems. First, as North emphasizes, this approach narrowly limits the kinds of questions that can be investigated in economic history. Those issues that do not readily lend themselves to formulation in quantitative terms or for which statistical data are not available tend to be downplayed or neglected altogether. Thus the new economic historians are more likely to seek answers to questions like: What was the net contribution of the railroad to the growth of real GNP in the United States? Or, what has been the effect of the creation of the Federal Reserve System on the stability of the price level and real output? They are much less likely to address in a meaningful way the questions of what *motivated* the huge government land grants for railroad rights-of-way or the passage of the Federal Reserve Act.

In general, the question of *"Cui bono?"*—or "Who benefits?"—from changes in policies and institutions receives very little attention in the cliometric literature, because the evidence that one needs to answer it, bearing as it does on human motives, is essentially subjective and devoid of a measurable or even quantifiable dimension. This is not to deny that new economic historians have sought to explain the *ex post* aggregate distribution of income that results from a given change in the institutional framework or in the policy regime. What their method precludes them from doing is identifying the *ex ante* purposes as well as ideas about the most efficacious means of accomplishing these purposes that motivated the specific individuals who lobbied for or initiated the change that effected a new income distribution. However, avoiding such questions leaves the quantitative data themselves ultimately unexplained. The reason is that the institutions that contribute to their formation, such as the railroads or the Fed, are always the complex resultants of the purposive actions of particular individuals or groups of individuals aimed at achieving definite goals by the use of specific means. So the new economic history is not history in the traditional sense of an attempt to "understand" the human motives underlying the emergence of economic institutions and processes.

The second and even more profound flaw in the new economic history is the relationship it posits between theory and history. For North, history is the source of the "empirical evidence"—that is, "ideally, statistical data"—against which the economic theory is tested. This means that the claim to validity of a particular theorem is always tentative and defeasible, resting as it does on its nonfalsification in previous empirical tests. However, this also means that economic history must be continually revised, because the very theory which is employed to identify the causal relations between historical events can always be falsified by new evidence coming to light in the ongoing historical process. In other words, what the new economic historians characterize as "the intimate relationship between measurement and theory" is in reality the vicious circle that ensnares all attempts to invoke positivist precepts in the interpretation of history.[3] For if the theory used to interpret past events can always be invalidated by future events, then it is unclear whether theory is the *explanans* or the *explanand* in historical research.

Rothbard's approach to monetary history does not focus on measurement but on motives. Once the goals of the actors and their ideas about the appropriate means for achieving these goals have been established, economic theory, along with other sciences, is brought to bear to trace out the effects of these actions in producing the complex events and processes of history which are only partially and imperfectly captured in statistical data. This is not to say that Rothbard ignores the quantitative aspects of historical monetary processes. Indeed, his book abounds with money, price, and output data; but these data are

[3]Robert William Fogel, "The New Economic History: Its Findings and Methods," in *The Reinterpretation of American History*, Robert William Fogel and Stanley L. Engerman, eds. (New York: Harper and Row, 1971), p. 7.

always interpreted in terms of the motivations of those who have contributed to their formation. For Rothbard, a particular price datum is, no less than the Spanish-American War, a *historical event,* and its causes must be traced back to the subjective aims governing human plans and choices.

In flatly rejecting the positivist approach to economic history, Rothbard adopts the method of historical research first formulated by Ludwig von Mises. In developing this method, Mises correctly delineated, for the first time, the relationship between theory and history. It is Rothbard's great contribution in this volume—and his earlier *America's Great Depression*—to be the first to consistently apply it to economic history.[4] It is worth summarizing this method here for several reasons. First, Mises's writings on the proper method of historical research inexplicably have been almost completely ignored up to the present, even by those who have adopted Mises's praxeological approach in economics.[5] Second, familiarity with Mises's method of historical research illuminates the source and character of the remarkable distinctiveness of Rothbard's historical writings. In particular, it serves to correct the common but mistaken impression that Rothbard's historical writings, especially on the origin and development of the U.S. monetary system, are grounded in nothing more substantial than an idiosyncratic "conspiracy theory of history." Third, it gives us an opportunity to elucidate the important elaboration of Mises's method that Rothbard contributed and which he deploys to great effect in explicating the topic of this volume. And finally, we find in Mises's method a

[4]Murray N. Rothbard, *America's Great Depression*, 5th ed. (Auburn, Ala.: Mises Institute, 2000).

[5]As Rothbard has written of *Theory and History*, the book in which Mises gives this method its most detailed exposition, this work "has made remarkably little impact, and has rarely been cited even by the young economists of the recent Austrian revival. It remains by far the most neglected masterwork of Mises." Murray N. Rothbard, Preface to Ludwig von Mises's *Theory and History: An Interpretation of Social and Economic Evolution*, 2nd ed. (Auburn, Ala.: Mises Institute, 1985), p. xi.

definitive refutation of the positivist's claim that it is impossible to acquire real knowledge of subjective phenomena like human motives and that, therefore, economic history must deal exclusively with observable and measurable phenomena.

To begin with, Mises grounds his discussion of historical method on the insight that ideas are the primordial stuff of history. In his words:

> History is the record of human action. Human action is the conscious effort of man to substitute more satisfactory conditions for less satisfactory ones. Ideas determine what are to be considered more and less satisfactory conditions and what means are to be resorted to to alter them. Thus ideas are the main theme of the study of history. [6]

This is not to say that all history should be intellectual history, but that ideas are the ultimate cause of all social phenomena, including and especially economic phenomena. As Mises puts it,

> The genuine history of mankind is the history of ideas. It is ideas that distinguish man from all other beings. Ideas engender social institutions, political changes, technological methods of production, and all that is called economic conditions.[7]

Thus, for Mises, history

> establishes the fact that men, inspired by definite ideas, made definite judgments of value, chose definite ends, and resorted to definite means in order to attain the ends chosen, and it deals furthermore with the outcome of their actions, the state of affairs the action brought about.[8]

Ideas—specifically those embodying the purposes and values that direct action—are not only the point of contact

[6]Ibid., pp. 224–25.

[7]Ibid., p. 187.

[8]Ludwig von Mises, *The Ultimate Foundation of Economic Science: An Essay on Method*, 2nd ed. (Kansas City, Mo.: Sheed Andrews and McMeel, 1978), p. 45.

between history and economics, but differing attitudes toward them are precisely what distinguish the methods of the two disciplines. Both economics and history deal with individual choices of ends and the judgments of value underlying them. On the one hand, economic theory as a branch of praxeology takes these value judgments and choices as given data and restricts itself to logically inferring from them the laws governing the valuing and pricing of the means or "goods." As such, economics does not inquire into the individual's motivations in valuing and choosing specific ends. Hence, contrary to the positivist method, the truth of economic theorems is substantiated apart from and without reference to specific and concrete historical experience. They are the conclusions of logically valid deduction from universal experience of the fact that humans adopt means that they believe to be appropriate in attaining ends that they judge to be valuable.[9]

The subject of history, on the other hand, "is action and the judgments of value directing action toward definite ends."[10] This means that for history, in contrast to economics, actions and value judgments are not ultimate "givens" but, in Mises's words, "are the starting point of a specific mode of reflection, of the specific understanding of the historical sciences of human action." Equipped with the method of "specific understanding," the historian, "when faced with a value judgment and the resulting action . . . may try to understand how they originated in the mind of the actor."[11]

[9]It is true that in deriving theorems that apply to the specific conditions characterizing human action in our world, a few additional facts of a lesser degree of generality are inserted into the deductive chain of reasoning. These include the facts that there exists a variety of natural resources, that human labor is differentiated, and that leisure is valued as a consumer's good. See Mises, *Human Action*; Rothbard, *The Logic of Action I*; and Hoppe, *Economic Science and the Austrian Method.*

[10]Mises, *Theory and History*, p. 298.

[11]Ibid., p. 310.

The difference between the methods of economics and history may be illustrated with the following example. The economist qua economist "explains" the Vietnam War-era inflation that began in the mid-1960s and culminated in the inflationary recession of 1973–1975 by identifying those actions of the Fed with respect to the money supply that initiated and sustained it.[12] The historian, including the economic historian, however, must identify and then assign weights to all those factors that *motivated* the various members of the Fed's Board of Governors (or of the Federal Open Market Committee) to adopt this course of action. These factors include: ideology; partisan politics; pressure exerted by the incumbent administration; the grasp of economic theory; the expressed and perceived desires of the Fed's constituencies, including commercial bankers and bond dealers; the informal power and influence of the Fed chairman within the structure of governance; and so on.

In short, the economic historian must supply the motives underlying the actions that are relevant to explaining the historical event. And for this task, his only suitable tool is understanding. Thus, as Mises puts it,

> The scope of understanding is the mental grasp of phenomena which cannot be totally elucidated by logic, mathematics, praxeology, and the natural sciences to the extent that they cannot be cleared up by all these sciences.[13]

To say that a full explanation of any historical event, including an economic one, requires that the method of specific understanding be applied is not to diminish the importance of pure economic theory in the study of history. Indeed, as Mises points out, economics

[12]Some economists would date this inflation from 1965 to 1979, but the precise dates do not matter for our present purposes. See, for example, Thomas Mayer, *Monetary Policy and the Great Inflation in the United States: The Federal Reserve and the Failure of Macroeconomic Policy* (Northampton, Mass.: Edward Elgar, 1999).

[13]Mises, *Human Action*, p. 50.

> provides in its field a consummate interpretation of past events recorded and a consummate anticipation of the effects to be expected from future actions of a definite kind. Neither this interpretation nor this anticipation tells anything about the actual content and quality of the actual individuals' judgments of value. Both presuppose that the individuals are valuing and acting, but their theorems are independent of and unaffected by the particular characteristics of this valuing and acting.[14]

For Mises, then, if the historian is to present a complete explanation of a particular event, he must bring to bear not only his "specific understanding" of the motives of action but the theorems of economic science as well as those of the other "aprioristic," or nonexperimental sciences, such as logic and mathematics. He must also utilize knowledge yielded by the natural sciences, including the applied sciences of technology and therapeutics.[15] Familiarity with the teachings of all these disciplines is required in order to correctly identify the causal relevance of a particular action to a historical event, to trace out its specific consequences, and to evaluate its success from the point of view of the actor's goals.

For example, without knowledge of the economic theorem that, ceteris paribus, changes in the supply of money cause inverse changes in its purchasing power, a historian of the price inflation of the Vietnam War-era probably would ignore the Fed and its motives altogether. Perhaps, he is under the influence of the erroneous Galbraithian doctrine of administered prices with its implication of cost-push inflation.[16] In this case, he might concentrate exclusively and irrelevantly on the motives of union leaders in demanding large wage increases and on the objectives of the "technostructure" of large business firms in acceding to these demands and deciding what

[14]Mises, *Theory and History*, p. 309.

[15]Ibid., p. 301.

[16]John Kenneth Galbraith, *The New Industrial State* (New York: New American Library, 1967), pp. 189–207, 256–70.

part of the cost increase to pass on to consumers. Thus, according to Mises,

> If what these disciplines [i.e., the aprioristic and the natural sciences] teach is insufficient or if the historian chooses an erroneous theory out of several conflicting theories held by the specialists, his effort is misled and his performance is abortive.[17]

But what exactly is the historical method of specific understanding, and how can it provide true knowledge of a wholly subjective and unobservable phenomenon like human motivation? First of all, as Mises emphasizes, the specific understanding of past events is

> not a mental process exclusively resorted to by historians. It is applied by everybody in daily intercourse with all his fellows. It is a technique employed in all interhuman relations. It is practiced by children in the nursery and kindergarten, by businessmen in trade, by politicians and statesmen in affairs of state. All are eager to get information about other people's valuations and plans and to appraise them correctly.[18]

The reason this technique is so ubiquitously employed by people in their daily affairs is because all action aims at rearranging future conditions so that they are more satisfactory from the actor's point of view. However, the future situation that actually emerges always depends partly on the purposes and choices of others besides the actor. In order to achieve his ends, then, the actor must anticipate not only changes affecting the future state of affairs caused by natural phenomena, but also the changes that result from the conduct of others who, like him, are contemporaneously planning and acting.[19]

[17]Mises, *Theory and History*, p. 301.

[18]Ibid., p. 265.

[19]As Mises puts it, "Understanding aims at anticipating future conditions as far as they depend on human ideas, valuations, and actions." Mises, *Ultimate Foundation*, p. 49.

Understanding the values and goals of others is thus an inescapable prerequisite for successful action.

Now, the method that provides the individual planning action with information about the values and goals of other actors is essentially the same method employed by the historian who seeks knowledge of the values and goals of actors in bygone epochs. Mises emphasizes the universal application of this method by referring to the actor and the historian as "the historian of the future" and "the historian of the past," respectively.[20] Regardless of the purpose for which it is used, therefore, understanding

> aims at establishing the facts that men attach a definite meaning to the state of their environment, that they value this state and, motivated by these judgments of value, resort to definite means in order to preserve or to attain a definite state of affairs different from that which would prevail if they abstained from any purposeful reaction. Understanding deals with judgments of value, with the choice of ends and of the means resorted to for the attainment of these ends, and with the valuation of the outcome of actions performed.[21]

Furthermore, whether directed toward planning action or interpreting history, the exercise of specific understanding is not an arbitrary or haphazard enterprise peculiar to each individual historian or actor; it is the product of a discipline that Mises calls "thymology," which encompasses "knowledge of human valuations and volitions."[22] Mises characterizes this discipline as follows:

> Thymology is on the one hand an offshoot of introspection and on the other a precipitate of historical experience. It is what everybody learns from intercourse with his fellows. It is what a man knows about the way in which people value

[20]Mises, *Theory and History*, p. 320.

[21]Mises, *Ultimate Foundation*, p. 48.

[22]Mises, *Theory and History*, p. 265.

> different conditions, about their wishes and desires and their plans to realize these wishes and desires. It is the knowledge of the social environment in which a man lives and acts or, with historians, of a foreign milieu about which he has learned by studying special sources.[23]

Thus, Mises tells us, thymology can be classified as "a branch of history" since "[i]t derives its knowledge from historical experience."[24] Consequently, the epistemic product of thymological experience is categorically different from the knowledge derived from experiments in the natural sciences. Experimental knowledge consists of "scientific facts" whose truth is independent of time. Thymological knowledge is confined to "historical facts," which are unique and nonrepeatable events. Accordingly, Mises concludes,

> All that thymology can tell us is that in the past definite men or groups of men were valuing and acting in a definite way. Whether they will in the future value and act in the same way remains uncertain. All that can be asserted about their future conduct is speculative anticipation of the future based on specific understanding of the historical branches of the sciences of human action. . . . What thymology achieves is the elaboration of a catalogue of human traits. It can moreover establish the fact that certain traits appeared in the past as a rule in connection with certain other traits.[25]

More concretely, all our anticipations about how family members, friends, acquaintances, and strangers will react in particular situations are based on our accumulated thymological experience. That a spouse will appreciate a specific type of jewelry for her birthday, that a friend will enthusiastically endorse our plan to see a Clint Eastwood movie, that a particular student will complain about his grade—all these expectations are based on our direct experience of their past modes of valuing

[23]Ibid., p. 266.
[24]Ibid., p. 272.
[25]Ibid., pp. 272, 274.

and acting. Even our expectations of how strangers will react in definite situations or what course political, social, and economic events will take are based on thymology. For example, our reservoir of thymological experience provides us with the knowledge that men are jealous of their wives. Thus, it allows us to "understand" and forecast that if a man makes overt advances to a married woman in the presence of her husband, he will almost certainly be rebuffed and runs a considerable risk of being punched in the nose. Moreover, we may forecast with a high degree of certitude that both the Republican and the Democratic nominees will out-poll the Libertarian Party candidate in a forthcoming presidential election; that the price for commercial time during the televising of the Major League Soccer championship will not exceed the price for commercials during the broadcast of the Super Bowl next year; that the average price of a personal computer will be neither one million dollars nor ten dollars in three months; and that the author of this paper will never be crowned king of England. All of these forecasts, and literally millions of others of a similar degree of certainty, are based on the specific understanding of the values and goals motivating millions of nameless actors.

As noted, the source of thymological experience is our interactions with and observations of other people. It is

> acquired either directly from observing our fellow men and transacting business with them or indirectly from reading and from hearsay, as well as out of our special experience acquired in previous contacts with the individuals or groups concerned.[26]

Such mundane experience is accessible to all who have reached the age of reason and forms the bedrock foundation for forecasting the future conduct of others whose actions will affect their plans. Furthermore, as Mises points out, the use of thymological knowledge in everyday affairs is straightforward:

[26]Ibid., p. 313.

> Thymology tells no more than that man is driven by various innate instincts, various passions, and various ideas. The anticipating individual tries to set aside those factors that manifestly do not play any concrete role in the concrete case under consideration. Then he chooses among the remaining ones.[27]

To aid in this task of narrowing down the goals and desires that are likely to motivate the behavior of particular individuals, we resort to the "thymological concept" of "human character."[28] The concrete content of the "character" we attribute to a specific individual is based on our direct or indirect knowledge of his past behavior. In formulating our plans, "We assume that this character will not change if no special reasons interfere, and, going a step farther, we even try to foretell how definite changes in conditions will affect his reactions."[29] It is confidence in our spouse's "character," for example, that permits us to leave for work each morning secure in the knowledge that he or she will not suddenly disappear with the children and the family bank account. And our saving and investment plans involve an image of Alan Greenspan's character that is based on our direct or indirect knowledge of his past actions and utterances. In formulating our intertemporal consumption plans, we are thus led to completely discount or assign a very low likelihood to the possibility that he will either deliberately orchestrate a 10-percent deflation of the money supply or attempt to peg the short-run interest rate at zero percent in the foreseeable future.

Despite reliance on the tool of thymological experience, however, all human understanding of future events remains uncertain, to some degree, for these events are generally a complex resultant of various causal factors operating concurrently. All forecasts of the future, therefore, must involve not only an

[27]Ibid.

[28]Mises, *Ultimate Foundation*, p. 50.

[29]Ibid.

enumeration of the factors that operate in bringing about the anticipated result but also the weighting of the relative influence of each factor on the outcome. Of the two, the more difficult problem is that of apportioning the proper weights among the various operative factors. Even if the actor accurately and completely identifies all the causal factors involved, the likelihood of the forecast event being realized depends on the actor having solved the weighting problem. The uncertainty inherent in forecasting, therefore, stems mainly from the intricacy of assigning the correct weights to different actions and the intensity of their effects.[30]

While thymology powerfully, but implicitly, shapes everyone's understanding of and planning for the future in every facet of life, the thymological method is used deliberately and rigorously by the historian who seeks a specific understanding of the motives underlying the value judgments and choices of the actors whom he judges to have been central to the specific event or epoch he is interested in explaining. Like future events and situations envisioned in the plans of actors, all historical events and the epochs they define are unique and complex outcomes codetermined by numerous human actions and reactions. This is the meaning of Mises's statement,

> History is a sequence of changes. Every historical situation has its individuality, its own characteristics that distinguish it from any other situation. The stream of history never returns to a previously occupied point. History is not repetitious.[31]

It is precisely because history does not repeat itself that thymological experience does not yield certain knowledge of the cause of historical events in the same way as experimentation in the natural sciences. Thus the historian, like the actor, must resort to specific understanding when enumerating the

[30]Mises, *Theory and History*, pp. 306–08, 313–14.

[31]Ibid., p. 219.

various motives and actions that bear a causal relation to the event in question and when assigning each action's contribution to the outcome a relative weight. In this task, "Understanding is in the realm of history the equivalent, as it were, of quantitative analysis and measurement."[32] The historian uses specific understanding to try to gauge the causal "relevance" of each factor to the outcome. But such assessments of relevance do not take the form of objective measurements calculable by statistical techniques; they are expressed in the form of subjective "judgments of relevance" based on thymology.[33] Successful entrepreneurs tend to be those who consistently formulate a superior understanding of the likelihood of future events based on thymology.

The weighting problem that confronts actors and historians may be illustrated with the following example. The Fed increases the money supply by 5 percent in response to a 20-percent plunge in the Dow Jones Industrial Average—or, perhaps now, the NASDAQ—that ignites fears of a recession and a concomitant increase in the demand for liquidity on the part of households and firms. At the same time, OPEC announces a 10-percent increase in its member's quotas and the U.S. Congress increases the minimum wage by 10 percent. In order to answer the question of what the overall impact of these events will be on the purchasing power of money six months hence, specific understanding of individuals' preferences and expectations is required in order to *weight* and *time* the influence of each of these events on the relationship between the supply of and the demand for money. The ceteris-paribus laws of economic theory are strictly qualitative and only indicate the direction of the effect each of these events has on the purchasing power of money and that the change occurs during a sequential adjustment process so that some time must elapse before the full effect emerges. Thus the entrepreneur or economist must always supplement economic theory with an act of historical judgment or

[32]Mises, *Human Action*, p. 56.

understanding when attempting to forecast any economic quantity. The economic historian, too, exercises understanding when making judgments of relevance about the factors responsible for the observed movements of the value of money during historical episodes of inflation or deflation.

Rothbard's contribution to Mises's method of historical research involves the creation of a guide that mitigates some of the uncertainty associated with formulating judgments of relevance about human motives. According to Rothbard, "It is part of the inescapable condition of the historian that he must make estimates and judgments about human motivation even though he cannot ground his judgments in absolute and apodictic certainty."[34] But the task of assigning motives and weighting their relevance is rendered more difficult by the fact that, in many cases, historical actors, especially those seeking economic gain through the political process, are inclined to deliberately obscure the reasons for their conduct. Generally in these situations, Rothbard points out, "the actor himself tries his best to hide his economic motive and to trumpet his more abstract and ideological concerns."[35]

[33]Ibid. JOE, SHOULD THIS BE P. 57??

[34]Murray N. Rothbard, "Economic Determinism, Ideology, and The American Revolution," *The Libertarian Forum* 6 (November 1974): 4.

[35]Mises makes a similar point:

> The endeavors to mislead posterity about what really happened and to substitute a fabrication for a faithful recording are often inaugurated by the men who themselves played an active role in the events, and begin with the instant of their happening, or sometimes even precede their occurrence. To lie about historical facts and to destroy evidence has been in the opinion of hosts of statesmen, diplomats, politicians and writers a legitimate part of the conduct of public affairs and of writing history.

Mises concludes that one of the primary tasks of the historian, therefore, "is to unmask such falsehoods." Mises, *Theory and History*, pp. 291–92.

Rothbard contends, however, that such attempts to obfuscate or conceal the pecuniary motive for an action by appeals to higher goals are easily discerned and exposed by the historian in those cases "where the causal chain of economic interest to action is simple and direct."[36] Thus, for example, when the steel industry lobbies for higher tariffs or reduced quotas, no sane adult, and certainly no competent historian, believes that it is doing so out of its stated concern for the "public interest" or "national security." Despite its avowed motives, everyone clearly perceives that the primary motivation of the industry is economic, that is, to restrict foreign competition in order to increase profits. But a problem arises in those cases "when actions involve longer and more complex causal chains."[37] Rothbard points to the Marshall Plan as an example of the latter. In this instance, the widely proclaimed motives of the architects of the plan were to prevent starvation in Western European nations and to strengthen their resistance to the allures of Communism. Not a word was spoken about the goal that was also at the root of the Marshall Plan: promoting and subsidizing U.S. export industries. It was only through painstaking research that historians were later able to uncover and assess the relevance of the economic motive at work.[38]

Given the propensity of those seeking and dispensing privileges and subsidies in the political arena to lie about their true motives, Rothbard formulates what he describes as "a theoretical guide which will indicate in advance whether or not a historical action will be predominantly for economic, or for ideological, motives."[39] Now, it is true that Rothbard derives this guide from his overall worldview. The historian's worldview,

[36]Rothbard, "Economic Determinism," p. 4.

[37]Ibid.

[38]See, for example, David Eakins, "Business Planners and America's Postwar Expansion," in *Corporations and the Cold War,* David Horowitz, ed. (New York: Modern Reader, 1969), pp. 143–71.

[39]Rothbard, "Economic Determinism," p. 4.

however, should not be interpreted as a purely ideological construction or an unconscious reflection of his normative biases. In fact, every historian must be equipped with a worldview—an interrelated set of ideas about the causal relationships governing how the world works—in order to ascertain which facts are relevant in the explanation of a particular historical event. According to Rothbard, "Facts, of course, must be selected and ordered in accordance with judgments of importance, and such judgments are necessarily tied into the historian's basic world outlook."[40]

Specifically, in Mises's approach to history, the worldview comprises the necessary preconceptions regarding causation with which the historian approaches the data and which are derived from his knowledge of both the aprioristic and natural sciences. According to Mises:

> History is not an intellectual reproduction, but a condensed representation of the past in conceptual terms. The historian does not simply let the events speak for themselves. He arranges them from the aspect of the ideas underlying the formation of the general notions he uses in their presentation. He does not report facts as they happened, but only *relevant* facts. He does not approach the documents without presuppositions, but equipped with the whole apparatus of his age's scientific knowledge, that is, with all the teachings of contemporary logic, mathematics, praxeology, and natural science.[41]

So, for example, the fact that heavy speculation against the German mark accompanied its sharp plunge on foreign-exchange markets is not significant for an Austrian-oriented economic historian seeking to explain the stratospheric rise in

[40]Murray N. Rothbard, *Conceived in Liberty,* vol. 1, *A New Land, A New People: The American Colonies in the Seventeenth Century,* 2nd ed. (Auburn, Ala.: Mises Institute, 1999), p. 9.

[41]Mises, *Human Action,* pp. 47–48.

commodity prices that characterized the German hyperinflation of the early 1920s. This is because he approaches this event armed with the supply-and-demand theory of money and the purchasing-power-parity theory of the exchange rate. These "presuppositions" derived from praxeology lead him to avoid any attribution of causal significance to the actions of foreign exchange speculators in accounting for the precipitous decline of the domestic purchasing power of the mark. Instead they direct his attention to the motives of the German Reichsbank in expanding the money supply. In the same manner, a modern historian investigating the cause and dissemination of bubonic plague in fourteenth-century Europe would presuppose that the blossoming of religious heresy during that period would have no significance for his investigation. Instead he would allow himself to be guided by the conclusions of modern medical science regarding the epidemiology of the disease.

The importance of Rothbard's theoretical guide is that it adds something completely new to the historian's arsenal of scientific preconceptions that aids him in making judgments of relevance when investigating the motives of those who promote or oppose specific political actions. The novelty and brilliance of this guide lies in the fact that it is neither a purely aprioristic law like an economic theorem nor an experimentally established "fact" of the natural sciences. Rather it is a sociological generalization grounded on a creative blend of thymological experience and economic theory. At the core of this generalization is the insight that the State throughout history has been essentially an organization of a segment of the population that forsakes peaceful economic activity to constitute itself as a ruling class. This class makes its living parasitically by establishing a permanent hegemonic or "political" relationship between itself and the productive members of the population. This political relationship permits the rulers to subsist on the tribute or taxes routinely and "legally" expropriated from the income and wealth of the producing class. The latter class is composed of the "subjects" or, in the case of democratic states, the "taxpayers," who earn their living through the peaceful "economic means" of production and voluntary exchange. In contrast, constituents of the ruling class may be thought of as "tax-consumers" who earn their living through the coercive "political means" of taxation and the sale of monopoly privileges.[42]

Rothbard argues that economic logic dictates that the king and his courtiers, or the democratic government and its special interest groups, can never constitute more than a small minority of the country's population—that all States, regardless of their formal organization, must effectively involve oligarchic rule.[43] The reasons for this are twofold. First, the fundamentally parasitic nature of the relationship between the rulers and the ruled by itself necessitates that the majority of the population engages in productive activity in order to be able to pay the tribute or taxes extracted by the ruling class while still sustaining its own existence. If the ruling class comprised the majority of the population, economic collapse and systemic breakdown would swiftly ensue as the productive class died out. The majoritarian ruling class itself then would either be forced into productive activity or dissolve into internecine warfare aimed at establishing a new and more stable—that is, oligarchic—relationship between rulers and producers.

The second reason why the ruling class tends to be an oligarchy is related to the law of comparative advantage. In a world where human abilities and skills vary widely, the division of labor and specialization pervades all sectors of the

[42]For expositions of the view of the origin and nature of the state as a coercive organization of the political means for acquiring income, see Franz Oppenheimer, *The State* (New York: Free Life Editions, [1914] 1975); Albert J. Nock, *Our Enemy, The State* (New York: Free Life Editions, [1935] 1973); and Murray N. Rothbard, *For a New Liberty: The Libertarian Manifesto,* 2nd ed. (San Francisco, Calif.: Fox and Wilkes, 1996), pp. 45–69.

[43]Rothbard, *For a New Liberty*, pp. 49–50; and idem, "Economic Determinism," pp. 4–5.

economy as well as society as a whole. Thus, not only is it the case that a relatively small segment of the populace possesses a comparative advantage in developing new software, selling mutual funds, or playing professional football, it is also the case that only a fraction of the population tends to excel at wielding coercive power. Moreover, the law of comparative advantage governs the structure of relationships within as well as between organizations, accounting for the hierarchical structure that we almost invariably observe within individual organizations. Whether we are considering a business enterprise, a chess club, or a criminal gang, an energetic and visionary elite invariably comes to the fore, either formally or informally, to lead and direct the relatively inert majority. This "Iron Law of Oligarchy," as this internal manifestation of the law of comparative advantage has been dubbed, operates to transform an initially majoritarian democratic government, or even a decentralized republican government, into a tightly centralized State controlled by a ruling elite.[44]

The foregoing analysis leads Rothbard to conclude that the exercise of political power is inherently an oligarchic enterprise. The small minority that excels in wielding political power will tend to coalesce and devote an extraordinary amount of mental energy and other resources to establishing and maintaining a permanent and lucrative hegemonic bond over the productive majority. Accordingly, since politics is the main source of their income, the policies and actions of the members of this oligarchic ruling class will be driven primarily by economic motives. The exploited producing class, in contrast, will not expend nearly as many resources on politics, and their actions in the political arena will not be motivated by economic gain to the same degree, precisely because they are absorbed in earning

[44]One of the first expositions of the operation of this law, within the context of social democratic political parties can be found in Robert Michels, *Political Parties: A Sociological Study of the Oligarchical Tendencies of Modern Democracy (*New York: Dover Publications, [1915] 1959).

their livelihoods in their own chosen areas of specialization on the market. As Rothbard explains:

> the ruling class, being small and largely specialized, is motivated to think about its economic interests twenty-four hours a day. The steel manufacturers seeking a tariff, the bankers seeking taxes to repay their government bonds, the rulers seeking a strong state from which to obtain subsidies, the bureaucrats wishing to expand their empire, are all professionals in statism. They are constantly at work trying to preserve and expand their privileges.[45]

The ruling class, however, confronts one serious and ongoing problem: how to persuade the productive majority, whose tribute or taxes it consumes, that its laws, regulations, and policies are beneficial; that is, that they coincide with "the public interest" or are designed to promote "the common good" or to optimize "social welfare." Given its minority status, failure to solve this problem exposes the political class to serious consequences. Even passive resistance by a substantial part of the producers, in the form of mass tax resistance, renders the income of the political class and, therefore, its continued existence extremely precarious. More ominously, attempts to suppress such resistance may cause it to spread and intensify and eventually boil over into an active revolution whose likely result is the forcible ousting of the minority exploiting class from its position of political power. Here is where the intellectuals come in. It is their task to convince the public to actively submit to State rule because it is beneficial to do so, or at least to passively endure the State's depredations because the alternative is anarchy and chaos. In return for fabricating an ideological cover for its exploitation of the masses of subjects or taxpayers, these "court intellectuals" are rewarded with the power, wealth, and prestige of a junior partnership in the ruling elite. Whereas in preindustrial times these apologists for State rule were associated with the clergy, in modern times—at least since the Progressive

[45]Rothbard, "Economic Determinism," p. 5.

Era in the U.S.—they have been drawn increasingly from the academy.[46]

Politicians, bureaucrats, and those whom they subsidize and privilege within the economy thus routinely trumpet lofty ideological motives for their actions in order to conceal from the exploited and plundered citizenry their true motive of economic gain. In today's world, these motives are expressed in the rhetoric of "social democracy" in Europe and that of modern—or welfare-state—liberalism in the United States.[47] In the past, ruling oligarchies have appealed to the ideologies of royal absolutism, Marxism, Progressivism, Fascism, National Socialism, New Deal liberalism, and so on to camouflage their economic goals in advocating a continual aggrandizement of State power. In devising his theoretical guide, then, Rothbard seeks to provide historians with a means of piercing the shroud of ideological rhetoric and illuminating the true motives underlying the policies and actions of ruling elites throughout history. As Rothbard describes this guide, whenever the would-be or actual proprietors and beneficiaries of the State act,

> when they form a State, or a centralizing Constitution, when they go to war or create a Marshall Plan or use and increase

[46]On the alliance between intellectuals and the State, see Rothbard, *For a New Liberty*, pp. 54–69. A particularly graphic example of this alliance can be found in late-nineteenth-century Germany, where the economists of the German Historical School were referred to as "Socialists of the Chair," because they completely dominated the teaching of economics at German universities. They also explicitly viewed their role as providing an ideological shield for the royal line that ruled Germany and proudly proclaimed themselves to be "the Intellectual Bodyguard of the House of Hohenzollern." Ibid., p. 60.

[47]So-called "neo-conservatism," which dominates the conservative movement and the Republican Party in the United States, is merely a variant of modern liberalism. Its leading theoreticians envision a slightly smaller and more efficient welfare state, combined with a larger and more actively interventionist global-warfare state.

> State power in any way, their *primary* motivation is economic: to increase their plunder at the expense of the subject and taxpayer. The ideology that they profess and that is formulated and spread through society by the Court Intellectuals is merely an elaborate rationalization for their venal economic interests. The ideology is the smokescreen for their loot, the fictitious clothes spun by the intellectuals to hide the naked plunder of the Emperor. The task of the historian, then, is to penetrate to the essence of the transaction, to strip the ideological garb from the Emperor State and to reveal the economic motive at the heart of the issue.[48]

In characterizing the modern democratic State as essentially a means for coercively redistributing income from producers to politicians, bureaucrats, and special interest groups, Rothbard opens himself up to the charge of espousing a conspiracy theory of economic history. But it is his emphasis on the almost universal propensity of those who employ the political means for economic gain to conceal their true motives with ideological cant that makes him especially susceptible to this charge. Indeed, the Chicago School's theory of economic regulation and the public choice theory of the Virginia School also portray politicians, bureaucrats, and industries regulated by the State as interested almost exclusively in maximizing their utility in the narrow sense, which in many, if not most, cases involves a maximization of pecuniary gain.[49] However, economists of both schools are inured against the charge of conspiracy theory because in their applied work they generally eschew a systematic, thymological investigation of the actual motives of those

[48]Rothbard, "Economic Determinism," p. 5.

[49]For examples, see, respectively, George J. Stigler, "The Theory of Economic Regulation," in *The Citizen and the State: Essays on Regulation* (Chicago: University of Chicago Press, 1975), pp. 114–41; and James M. Buchanan, "Politics without Romance: A Sketch of Positive Public Choice Theory and Its Normative Implications," in *The Theory of Public Choice—II*, James M. Buchanan and Robert D. Tollison, eds. (Ann Arbor: University of Michigan Press, 1984), pp. 11–22.

individuals or groups whose actions they are analyzing. Instead, their positivist methodology inclines them to mechanically impute to real actors in concrete historical circumstances a narrowly conceived utility maximization.

James Buchanan, one of the founders of public choice theory, writes, for instance, that economists pursuing this paradigm tend

> to bring with them models of man that have been found useful within economic theory, models that have been used to develop empirically testable and empirically corroborated hypotheses. These models embody the presumption that persons seek to maximize their own utilities, and their own narrowly defined economic well-being is an important component of these utilities.[50]

George Stigler, who pioneered the theory of economic regulation, argues, "There is, in fact, only one theory of human behavior, and that is the utility-maximizing theory." But for Stigler, unlike Rothbard or Mises, the exact arguments of the utility function of flesh-and-blood actors are not ascertained by the historical method of specific understanding but by the empirical method. Thus, Stigler argues:

> The first purpose of the empirical studies [of regulatory policy] is to identify the purpose of the legislation! The announced goals of a policy are sometimes unrelated or perversely related to its actual effects and the *truly intended effects should be deduced from the actual effects*. This is not a tautology designed to gloss over a hard problem, but instead a hypothesis on the nature of political life. . . . If an economic policy has been adopted by many communities, or if it is persistently pursued by a society over a long span of time, it is fruitful to assume that the real effects were known and desired.[51]

By thus discounting the effect of erroneous ideas about the appropriate means for achieving preferred goals on the choices

[50]Buchanan, "Politics without Romance," p. 13.

[51]Stigler, "Theory of Economic Regulation," p. 140.

made by historical actors, Stigler the positivist seeks to free himself from the task of delving into the murky and unmeasurable phenomenon of motives. Without doubt, if the historical outcome of a policy or action is always what was aimed at by an individual or organization—because, according to Stigler, "errors are not what men live by or on"—then there is no need to ever address the question of motive. For Stigler, then, there is no reason for the historian to try to subjectively understand the motive for an action because the actor's goal is objectively revealed by the observed result. Now, Stigler would probably agree that it is absurd to assume that Hitler was aiming at defeat in World War II by doggedly pursuing his disastrous policy on the Eastern front over an extended period of time. But this assumption only appears absurd to us in light of the thymological insight into Hitler's mind achieved by examining the records of his actions, policies, utterances, and writings, and those of his associates. This insight leads us to an *understanding*, which cannot be reasonably doubted by anyone of normal intelligence, that Hitler was fervently seeking victory in the war.

Rothbard insists that the same method of specific understanding that allows the historian to grasp Hitler's objectives in directing the German military campaign against the Soviet Union also is appropriate when attempting to discern the motives of those who lobby for a tariff or for the creation of a central bank. Accordingly, the guide that Rothbard originates to direct the economic historian first to a search for evidence of an unspoken economic motive in such instances is only a guide. As such, it can never rule out in advance the possibility that an ideological or altruistic goal may serve as the dominant motivation in a specific case. If his research turns up no evidence of a hidden economic motive, then the historian must explore further for ideological or other noneconomic motives that may be operating. Thus, as Rothbard points out, his approach to economic history, whether it is labeled a "conspiracy theory of history" or not, "is really only praxeology applied to human history, in assuming that men have motives on which they act."[52] This approach also respects what Mises has called "historical individuality" by assuming that "[t]he characteristics of individual men, their ideas and judgments of value as well as the actions guided by those ideas and judgments, cannot be traced back to something of which they would be the derivatives."[53] In sharp contrast, the positivist methods of Stigler and Buchanan attempt to force participants in historical events into the Procrustean bed of *homo economicus*, who ever and unerringly seeks for his own economic gain.

We can more fully appreciate the significance of Rothbard's methodological innovation by briefly contrasting his explanation of the origins of the Federal Reserve System with the explanation given by Milton Friedman and Anna J. Schwartz in their influential work, *A Monetary History of the United States, 1867–1960*.[54] Since its publication in 1963, this book has served as the standard reference work for all subsequent research in U.S. monetary history. While Friedman and Schwartz cannot exactly be classified as new economic historians, their book is written from a strongly positivist viewpoint and its methods are congenial to those pursuing research in this paradigm.[55] For example, in the preface to the book, Friedman and Schwartz write that their aim is "to provide a prologue and a background for a statistical analysis of the secular and cyclical behavior of money in the United States, and to exclude any material not relevant to that purpose." In particular it is not their ambition to write "a full-scale economic and political history that would be required to record at all comprehensively the role of money in

[52]Murray N. Rothbard, "Only One Heartbeat Away," *The Libertarian Forum* 6 (September 1974): 5.

[53]Mises, *Theory and History*, p. 183.

[54]Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton, N.J.: Princeton University Press, 1963).

[55]See, for example, North, *Growth and Welfare in the American Past*, p. 11, n. 6.

the United States in the past century."[56] Thus, in effect, the behavior of the unmotivated money supply takes center stage in this tome of 808 pages including appendices. Indeed, the opening sentence of the book reads, "This book is about the stock of money in the United States."[57]

Now Friedman and Schwartz certainly do not, and would not, deny that movements in the money supply are caused by the purposeful actions of motivated human beings. Rather, the positivist methodology they espouse constrains them to narrowly focus their historical narrative on the observable outcomes of these actions and never to formally address their motivation. For, according to the positivist philosophy of science, it is only observable and quantifiable phenomena that can be assigned the status of "cause" in a scientific investigation, while human motives are intensive qualities lacking a quantifiable dimension. So, if one is to write a monetary history that is scientific in the strictly positivist sense, the title must be construed quite literally as the chronicling of quantitative variations in a selected monetary aggregate and the measurable effects of these variations on other quantifiable economic variables, such as the price level and real output.

However, even Friedman and Schwartz's *Monetary History* must occasionally emerge from the bog of statistical analysis and address human motivation in order to explain the economic events, intellectual controversies, social conflicts, and

[56]Friedman and Schwartz, *A Monetary History,* p. xxii.

[57]Ibid., p. 3. As doctrinaire positivists, Friedman and Schwartz consistently refer to the "stock" or "quantity" of money rather than to the "supply" of money, presumably because the former is the observable market outcome of the interaction of the unobservable money supply and money demand curves. However, it is likely that Friedman and Schwartz conceive the money stock as a good empirical proxy for the money supply, because they view the latter as perfectly inelastic with respect to the price level. On this point, compare Peter Temin's interpretation. Peter Temin, *Did Monetary Forces Cause the Great Depression?* (New York: W.W. Norton, 1976), p. 18.

political maneuverings that had an undeniable and fundamental impact on the institutional framework of the money supply. Due to the awkward fit of motives into the positivist framework, however, Friedman and Schwartz's forays into human history tend to be cursory and unilluminating, when not downright misleading. For example, their two chapters dealing with the crucial period from 1879 to 1914 in U.S. monetary history comprise one hundred pages, only eleven of which are devoted to discussing the political and social factors that culminated in the establishment of the Federal Reserve System.[58] In these pages, Friedman and Schwartz suggest that the "money 'issue'" that consumed American politics in the last three decades of the nineteenth century was precipitated by "the crime of 1873" and was almost exclusively driven by the silver interests in league with the inflationist and agrarian Populist Party. This movement, moreover, was partly expressive of the 1890s, a decade which, according to C. Vann Woodward as quoted by the authors, "had rather more than its share of zaniness and crankiness, and that these qualities were manifested in the higher and middling as well as lower orders of American society."[59] In thus trivializing the "money issue," the authors completely ignore the calculated and covert drive by the Wall Street banks led by the Morgans and Rockefellers for a cartelization of the entire banking industry, with themselves and their political allies at the helm. This movement, which began in earnest in the 1890s, was also in part a reaction to the proposals of the silverite and agrarian inflationists and was aimed at reserving to the banks the gains forthcoming from monetary inflation.

Friedman and Schwartz thus portray the drive toward a central bank as completely unconnected with the money issue and as only getting under way in reaction to the panic of 1907 and the problem with the "inelasticity of the currency" that was then commonly construed as its cause. The result is that they

[58]Friedman and Schwartz, *A Monetary History,* pp. 89–188.

[59]Ibid., p. 115, n. 40.

characterize the Federal Reserve System as the product of a straightforward, disinterested, bipartisan effort to provide a practical solution to a purely technical problem afflicting the monetary system.[60] Nowhere in their discussion of the genesis of the Federal Reserve System do Friedman and Schwartz raise the all-important question of precisely which groups benefitted from this "solution." Nor do they probe deeply into the motives of the proponents of the Federal Reserve Act. After a brief and superficial account of the events leading up to the enactment of the law, they hasten to return to the main task of their "monetary history" which, as Friedman expresses it in another work, is "to add to our tested knowledge."[61]

For Friedman and Schwartz, then, the central aim of economic history is the testing of hypotheses suggested by empirical regularities observed in the historical data. Accordingly, Friedman and Schwartz describe their approach to economic history as "conjectural history—the tale of 'what might have been.'"[62] In their view, the primary task of the economic historian is to identify the observable set of circumstances that accounts for the emergence of the historical events under investigation by formulating and testing theoretical conjectures about the course of events that would have developed in the absence of these circumstances. This "counterfactual method," as the new economic historians refer to it, explains the historical events in question and, at the same time, adds to the "tested knowledge" of theoretical relationships to be utilized in future investigations in economic history.[63]

[60]Ibid., p. 171.

[61]Milton Friedman, "The Quantity Theory of Money—A Restatement," in *Studies in the Quantity Theory of Money* (Chicago: University of Chicago Press, [1956] 1973), p. 18.

[62]Ibid., p. 168.

[63]For more on the nature and use of the counterfactual method, see Robert William Fogel, "The New Economic History: Its Findings and Methods," in *The Reinterpretation of American History,* Robert William

Friedman and Schwartz exemplify this method in their treatment of the panic of 1907.[64] During this episode, banks swiftly restricted cash payments to their depositors within weeks after the financial crisis struck, and there ensued no large-scale failure or even temporary closing of banks. Friedman and Schwartz formulate from this experience the theoretical conjecture that, when a financial crisis strikes, early restrictions on currency payments work to prevent a large-scale disruption of the banking system. They then test this conjecture by reference to the events of 1929–1933. In this case, although the financial crisis began with the crash of the stock market in October 1929, cash payments to bank depositors were not restricted until March 1933. From 1930 to 1933, there occurred a massive wave of bank failures. The theoretical conjecture, or "counterfactual statement," that a timely restriction of cash payments would have checked the spread of a financial crisis, is therefore empirically validated by this episode because, in the absence of a timely bank restriction, a wave of bank failures did, in fact, occur after 1929.

Granted, Friedman and Schwartz do recognize that these theoretical conjectures cannot be truly tested because "[t]here is no way to repeat the experiment precisely and so to test these conjectures in detail." Nonetheless, they maintain that "all analytical history, history that seeks to interpret and not simply record the past, is of this character, which is why history must be continuously rewritten in the light of new evidence as it unfolds."[65] In other words, history must be revised repeatedly because the very theory that is employed to interpret it is itself subject to constant revision on the basis of "new evidence" that

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Fogel and Stanley L. Engerman, eds. (New York: Harper and Row, 1971), pp. 8–10; and Donald N. McCloskey, "Counterfactuals," in *The New Palgrave: The New World of Economics*, John Eatwell, Murray Milgate, and Peter Newman, eds. (New York: W.W. Norton, 1991), pp. 149–54.

[64]Friedman and Schwartz, *A Monetary History*, pp. 156–68.

[65]Ibid., p. 168.

is continually coming to light in the ongoing historical process. As pointed out above, this is the vicious circle that characterizes all attempts to apply the positive method to the interpretation of history.

As if to preempt recognition of this vicious circle, Friedman and Schwartz take as the motto of their volume a famous quote from Alfred Marshall, which reads in part:

> Experience . . . brings out the impossibility of learning anything from facts till they are examined and interpreted by reason; and teaches that the most reckless and treacherous of all theorists is he who professes to let facts and figures speak for themselves. [66]

But clearly, reason teaches us that the observable—and, in some cases, countable, but never measurable—events of economic history ultimately are caused by the purposive actions of human beings whose goals and motives can never be directly observed. In rejecting the historical method of specific understanding, Friedman and Schwartz are led not by reason, but by a narrow positivist prepossession with using history as a laboratory, albeit imperfect, for formulating and testing theories that will allow prediction and control of future phenomena. Of the underlying intent of such a positivist approach to history, Mises wrote, "This discipline will abstract from historical experience laws which could render to social 'engineering' the same services the laws of physics render to technological engineering."[67]

Needless to say, for Rothbard, history can never serve even as an imperfect laboratory for testing theory, because of his agreement with Mises that "the subject matter of history . . . is value judgments and their projection into the reality of change."[68] In seeking to explain the origins of the Federal Reserve System, therefore, Rothbard focuses on the question of

[66]Ibid., p. xix.

[67]Mises, *Theory and History,* p. 285.

[68]Mises, *Human Action,* p. 48.

who would reasonably have expected to benefit from and valued such a radical change in the monetary system. Here is where Rothbard's scientific worldview comes into play. As an Austrian monetary theorist, he recognizes that the limits on bank credit inflation confronted by a fractional-reserve banking system based on gold are likely to be much less confining under a central bank than under the quasi-decentralized National Banking System put in place immediately prior to the passage of the Federal Reserve Act in 1913. The praxeological reasoning of Austrian monetary theory also leads to the conclusion that those who stand to reap the lion's share of the economic benefits from a bank credit inflation tend to be the lenders and first recipients of the newly-created notes and deposits, namely, commercial and investment bankers and their clients. Guided by the implications of this praxeological knowledge and of his thymological rule about the motives of those who lobby for State laws and regulations, Rothbard is led to scrutinize the goals and actions of the large Wall Street commercial and investment bankers, their industrial clientele, and their relatives and allies in the political arena.

Rothbard's analysis of the concrete evidence demonstrates that, beginning in the late 1890s, a full decade before the panic of 1907, this Wall Street banking axis and allied special interests began to surreptitiously orchestrate and finance an intellectual and political movement agitating for the imposition of a central bank. This movement included academic economists who covered up its narrow and venal economic interests by appealing to the allegedly universal economic benefits that would be forthcoming from a central bank operating as a benevolent and disinterested provider of an "elastic" currency and "lender of last resort." In fact, what the banking and business elites dearly desired was a central bank that would provide an elastic supply of paper reserves to supplement existing gold reserves. Banks' access to additional reserves would facilitate a larger and more lucrative bank credit inflation and, more important, would provide the means to ward off or mitigate the recurrent financial crises that had brought past inflationary booms to an abrupt and disastrous end in bank failures and industrial depression.

Rothbard employs the approach to economic history exemplified in this treatment of the origins of the Fed consistently and dazzlingly throughout this volume to unravel the causes and consequences of events and institutions ranging over the course of U.S. monetary history, from colonial times through the New Deal era. One of the important benefits of Rothbard's unique approach is that it naturally leads to an account of the development of the U.S. monetary system in terms of a compelling narrative linking human motives and plans that oftentimes are hidden and devious to outcomes that sometimes are tragic. And one will learn much more about monetary history from reading this exciting story than from poring over reams of statistical analysis.

Although its five parts were written separately, this volume presents a relatively integrated narrative, with very little overlap, that sweeps across three hundred years of U.S. monetary history. Part 1, "The History of Money and Banking before the Twentieth Century," consists of Rothbard's contribution to the minority report of the U.S. Gold Commission and treats the evolution of the U.S. monetary system from its colonial beginnings to the end of the nineteenth century. [69] In this part, Rothbard gives a detailed account of two early and abortive attempts by the financial elites to shackle the young republic with a quasi-central bank. He demonstrates the inflationary consequences of these privileged banks, the First and Second Banks of the United States, during their years of operation, from 1791 to 1811 and from 1816 to 1833, respectively. Rothbard then discusses the libertarian Jeffersonian and Jacksonian ideological movements that succeeded in destroying these statist and inflationist institutions. This is followed by discussions of the era of

[69]Rep. Ron Paul and Lewis Lehrman, *The Case for Gold: A Minority Report of the U.S. Gold Commission* (Washington, D.C.: Cato Institute, 1982), pp. 17–118.

comparatively free and decentralized banking that extended from the 1830s up to the Civil War, and the pernicious impact of the war on the U.S. monetary system. Part 1 concludes with an analysis and critique of the post-Civil War National Banking System. Rothbard describes how this regime—which was aggressively promoted by the investment banking firm that had acquired the monopoly of underwriting government bonds—centralized banking and destabilized the economy, resulting in a series of financial crises that prepared the way for the imposition of the Federal Reserve System.

Part 2, on the "Origins of the Federal Reserve," is a paper that lay unpublished for a long time and just appeared in a recent issue of *The Quarterly Journal of Austrian Economics*.[70] Its main argument is summarized in the text above.

Part 3 contains a formerly unpublished paper, "From Hoover to Roosevelt: The Federal Reserve and the Financial Elites." Here, Rothbard identifies the financial interests and ideology that drove the Fed to engineer an almost uninterrupted expansion of the money supply from the moment of its inception in 1914 through 1928. This part also includes an analysis of how concordance and conflict between the Morgan and Rockefeller financial interests shaped the politics and behavior of the Fed during the Hoover administration and the first Roosevelt administration as well as international monetary and domestic banking and financial policies under the latter administration.

Part 4, "The Gold-Exchange Standard in the Interwar Years," previously was published as a chapter in a collection of papers on money and the State.[71] The paper appears here for the first

[70]Murray N. Rothbard, "The Origins of the Federal Reserve System," *Quarterly Journal of Economics* 2, no. 3 (Fall 1999): 3–51.

[71]A version of this piece appeared as Murray N. Rothbard, "The Gold-Exchange Standard in the Interwar Years," in *Money and the Nation State: The Financial Revolution, Government and the World Monetary System*, Kevin Dowd and Richard H. Timberlake, Jr., eds. (New Brunswick, N.J.: Transactions Publishers, 1998), pp. 105–63.

time in its original and unexpurgated version. Rothbard elucidates the reasons why the British and U.S. governments in the 1920s so eagerly sought to reconstruct the international monetary system on the basis of this profoundly flawed and inflationary caricature of the classical gold standard. Rothbard also analyzes the "inner contradictions" of the gold-exchange-standard system that led inexorably to its demise in the early 1930s.

Part 5, "The New Deal and the International Monetary System" is the topic of the fifth and concluding part of the book and was previously published in an edited book of essays on New Deal foreign policy.[72] Rothbard argues that an abrupt shift occurred in the international monetary policy of the New Deal just prior to U.S. entry into World War II. He analyzes the economic interests that promoted and benefitted from the radical transformation of New Deal policy from "dollar nationalism" during the 1930s to the aggressive "dollar imperialism" that prevailed during the war and culminated in the Bretton Woods Agreement of 1944.

—Joseph T. Salerno

[72]Murray N. Rothbard, "The New Deal and the International Monetary System," in *Watershed of Empire: Essays on New Deal Foreign Policy,* Leonard P. Liggio and James J. Martin, eds. (Colorado Springs, Colo.: Ralph Myles, 1976), p. 19.