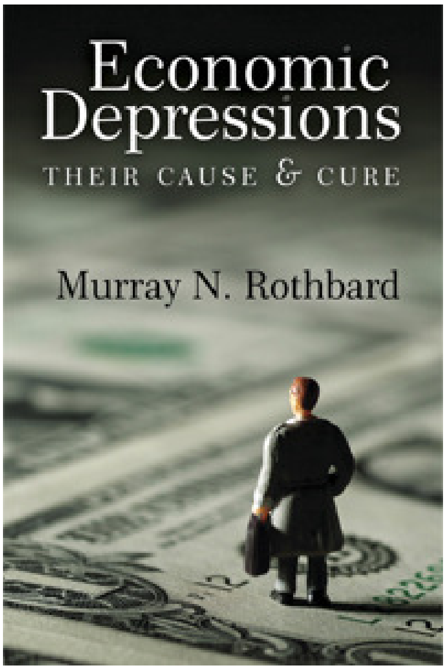

Economic Depressions

Murray N. Rothbard

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Murray Rothbard was the master of reducing complicated theories to their very essence while retaining theoretical rigor, and this essay is a case in point. It was written in 1969 and published in the form of a tiny book that achieved a huge circulation. It has not been in print since that time, but it is now back in this new release.

It is thrilling how Rothbard is able to present the theory in an easy-to-digest format.

Its continued relevance speaks to an aspect of the Austrian theory that other theories can't boast. It is a real theory that applies across time and place, and its persuasive power is not contingent on the particulars of any individual boom bust cycle.

You will not only learn from this 50-page book; it is the perfect item to pass on to others who are wondering about the economic crisis of 2008 and following.

Economic Depressions Details

Date	:	Published 2009 by Ludwig van Mises (first published 1969)
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Author	:	Murray N. Rothbard
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From Reader Review Economic Depressions for online ebook

Yifan (Evan) Xu (Hsu) says

? I have neither the competence nor the intent to evaluate theories proposed in this book. But there is the little wishful thought to synthesize their logical components and understand them with my own words.
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??The following is the synthesis of the book:
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??Part I - Attack the Keynesians
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??Rothbard criticized the view of Keynesians towards business cycle is simplicit and even naivete:
?? 1) If there is inflation, then it must be caused by excessive spending of private consumers. To reduce public spending, government must step in and increase tax to force people to spend less.
?? 2) If there is a recession, then it must be caused by insufficient spending. To increase overall spending, government must, again, step in and increase government spending.
??
??He then raised the underlying questions: What causes periodic depressions, the booms and the busts? Is the prevailing view that business cycle is rooted in free market economy true?
??
??In route to answering the questions, he first mention KM's theory from which the current fashionable attitude derived. KM discovered that there was not business cycle before industrial evolution in late 18th century. So KM concluded that business cycle was an inherent feature of the capitalist market economy.
??
??But KM's view is wrong, according to Rothbard, for three reasons:
?? 1) There is nothing in general and comprehensive theory of the market system that would explain business cycles. But current academics tend to use separated and mutually exclusive compartments of theories to account for business cycle.
?? 2) No current theory can explain the epidemic breakdown of the entrepreneurial function at times of economic crisis.
?? Due to natural selection process of business, those who survived and succeeded businesses must be good forecasters of future prospects. But at times of crisis, almost all of them failed to predict the upcoming crisis, why is that?
?? 3) During depressions, capital goods industries were always hit first and hardest, and current Keynesians theory failed to explain. If the culprit is lack of private spending, then why consumer-serving industries are the last and the least to fall in any depressions?
??
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??Part II - Introducing Ricardian Theory
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??Then, Rothbard started to introduce the correct view by first mentioning Ricardian theory.
??The significance of R theory is the incorporation of banking and credit supply into consideration. I summarized its basic theory into the following credit-economy interaction steps. And please note that Ricardian theory is based on the assumption of gold standard and non-existence of a central bank.
?? 1) Bank expand credit by supplying gold deposits to the market of Country X
?? 2) Income and expenditures of country X rise, which then increase prices of goods in Country X
?? 3) The result is inflation and economic boom in X

?? 4) Rise in expenditure and prices of goods cause the net import to X increase, and thus deficit of balance occurs
?? 5) Currency of X, the gold deposit, start to flow out of X into other countries. But foreign exporters do not want gold deposit from X, and instead they want gold itself.
?? 6) So, exporters start to redeem gold from those issuing banks. Such redemption cause a dwindling gold base in X's banks.
?? 7) There will be a point when banks in X start to frighten, since gold base is decreasing while deposits continue to be generated.
?? 8) Then, banks in X will stop credit expansion. Such credit contraction will effect mostly domestic borrowers and thus caused economic downturn.
?? 9) However, the process will re-balance the economic conditions. Fall in credit supply will lead to a general fall in the supply of bank deposits, or money, which will then lead to a fall of prices in X.
?? 10) Fall of prices in X will make X's goods more competitive in international markets. Thus exports will exceed imports, and gold will flow into country X.
?? 11) Money supply will then contract on top of an expanding gold base, and the condition of the banks becomes much sounder.
??
??From this, we can see that banks are the integral part of business cycle in this theory. But, in a free banking market where a central bank does not exist, banks won't cause severe depression. If banks are truly competitive, any expansion of credit by one bank will pile up debt of that bank in its competitors' balances. Its competitors can attack that bank by calling upon that bank for redemption of gold. Essentially, its competitors will do the exactly the same thing as foreign exports, but they would do it immediately so that any inflation will be ceased before accumulation.
??
??Banks can only expand uncontrolled credit for any length of time, when a central bank exists, enjoying a monopoly granted by the government. Central banking works as a banking cartel to expand banks' liabilities in the form of central bank notes rather than gold.
??
??Thus, Ricardian theory concluded that business cycle is caused by systematic intervention by government in the market process.
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??Part III - Mises Theory
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??Section I
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??Rothbard thought that a breakthrough of Mises theory is the discovery of the association between interest rate and business cycle.
?? 1) Interest rate, fundamentally, reflect public consumers' time-preference. Consumers valuing now more than future, intend to spend more and save less, and thus interest rate will rise; when consumers valuing future more than now, they tend to save more and spend less, and thus interest rate will fall. Rothbard argued that economic growth comes about largely as the result of falling rates of time-preference, aka increase of saving and lowering of interest rate.
?? 2) But, if the fall of interest rate is not caused by consumer's lower time-preference but government's promotion of credit, what would follow?
?? (1) Artificially low interest rate will speed up investment in capital and producer's goods, since lower interest rate will pump up values and profitability of these investment projects.
?? (2) Newly injected credit in the form of investment will end up with workers in capital goods industry.
?? (3) However, worker's time-preference is comparatively towards presence and not low, they would spend

the newly earned money on consumption instead of saving it. This means that workers redirect the spending back to the consumer goods industries, and they don't save and invest enough to buy the newly-produced machines, capital equipment, industrial raw materials, etc.
?? (4) Thus, capital goods and producer's industries will suffered a decline.
?? => When the new bank money filtered through the system and the consumer reestablish their old consumption/investment proportions, it became clear that there were not enough savings to buy all the producer's goods, and that business had overinvested savings in capital goods and had underinvested in consumer goods.
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??Section II
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??Rothbard argued that in Mises theory, "depression" that naturally occurred was a healthy and necessary process of liquidating unsound, uneconomic investments. And if the credit expansion or money injection by the government is an one-shot affair, boom and depression will both occur quickly and end very soon. But, in reality, expansion proceeds on and on, never giving consumers the chance to reestablish their preferred proportions of consumption and saving. It is only when the bank credit expansion must finally stop that depression finally catch up with the boom. As soon as credit expansion stops, the inevitable readjustment will liquidate unsound investments of the boom, with the reassertion of a greater proportionate emphasis on consumers' goods production.
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??Section III
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??According to Mises theory, what should a government do during a depression?
??There are a few things that Rothbard discussed:
?? 1) Quickly bring inflation to an end.
?? 2) Never rescue unsound business, such as bailing out or lend money to business firms in trouble (draw some inference from 2008 credit crisis, LOL)
?? 3) Do not try to inflate again. Inflating the economy again via either encouragement of private consumption or governmental expenditure will sow greater trouble later on.
?? 4) What government needs is more saving rather than more consumption. So what should government do? Nothing, absolutely nothing.
??
??Section IV
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??Lastly, Rothbard described the development of Mises theory and its relationship with Keynesian theory.
??The key take-aways is the emerging "Keynesian Revolution" where Keynesians are now in general and massive retreat and money supply and bank credit theories advocated by Mises theory are being gradually acknowledged.

Andy Katherman says

Rothbard does it again with this excellent yet short book. He sums up the REAL reason why we have business cycles. After being told over and over again since 1936 that animal spirits and insufficient aggregate demand are the cause of the downturns, a cogent explanation of the business cycle that originated with Ricardo and refined by Mises and Hayek is put in laymens terms. Why the sudden cluster of errors by all these smart and successful entrepreneurs? Why do capital goods fall in price/demand much more than consumer goods? If supply and demand always move the economy towards equilibrium, how does the economy become so distorted so quickly? Rothbard shows us the answer to these 3 questions which lie in the Austrian theory and not the Keynesian theory. People are waking up to the Keynesian mirage that is neither a free lunch nor logical.

Jeffy Joseph says

I read this one a couple of months back. At the time it seemed like a great book. Explanations were clear and logically sound. But in retrospect I cant recall a single idea from the book. Considering my very selective amnesia when it comes to economics, there is probably nothing wrong with the book.

John Sharp says

Wow, quick, easy and to the point. Government interference in free markets, i.e. central banks, are what cause depressions. Currently, the Obama administration, has a plan to broaden the regulatory powers of the Federal Reserve. Bad idea, thier monetary policy is what caused this latest meltdown.

Spicy T AKA Mr. Tea says

Rothbard challenges the notion that the government has to play any role in market regulation. His solution? A hands-off approach. If we let the market regulate itself, then it will eventually return to its "natural state". This happens by a "necessary and healthy phase by which the market economy sloughs off and liquidates the unsound, uneconomic investments of the boom, and reestablishes the proportions between consumption and investment that are truly desired by the consumers." Sounds like some kind of economic utopia where markets are free roaming animals that need to be returned to nature. Thing is, in this "sloughing off" Rothbard neglects to tell us what happens to the mass population. Fend for themselves? Starve? They'll figure it out. Fuck this guy.

Brad Harris says

Short but great. introduced me to a lot of banking and credit concepts.
