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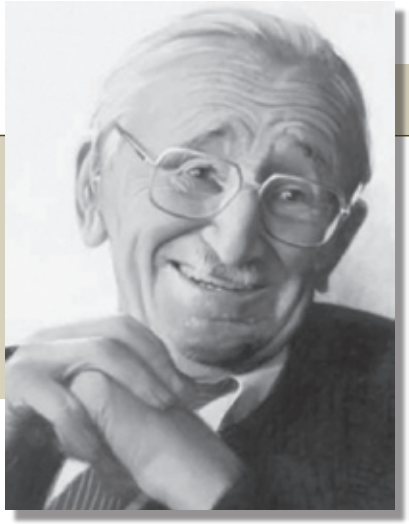

THE HAYEK LECTURE

The Fifth Annual Lecture
November 19, 2009

THE FORGOTTEN ECONOMY: THIS RECOVERY AND THE 1930S

by

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Manhattan Institute for Policy Research

The Hayek Lecture

Political philosopher and Nobel laureate F. A. Hayek, author of groundbreaking works such as *The Road to Serfdom and The Constitution of Liberty*, was the key figure in the twentieth century revival of classical liberalism. He was also a formative influence on the Manhattan Institute. When our founder, Sir Antony Fisher, asked how best to reverse the erosion of freedom, Hayek advised him not to begin with politics per se but to fight first on the battlefield of ideas. Our Hayek Lecture affirms and celebrates this mission. The Lecture is delivered by the recipient of the Hayek Prize—a new Manhattan Institute prize that honors the book published within the past two years that best reflects Friedrich von Hayek's vision of economic and individual liberty. The purpose of the award is to recognize the long-running influence of the *Road to Serfdom* and to encourage other scholars to follow Hayek's example. The winner of the Hayek Prize is chosen by a selection committee of distinguished economists and journalists and asked to deliver our annual Hayek Lecture. The winning author receives a $50,000 financial prize.

Amity Shlaes & Steve Forbes

AMITY SHLAES is senior columnist for *Forbes* magazine, a syndicated columnist for Bloomberg News, and senior fellow in economic history at the Council on Foreign Relations. Miss Shlaes is also an adjunct professor at New York University's Stern School of Business. In the 1990s, she served as a member of the editorial board of the *Wall Street Journal*. She is the author of *The Greedy Hand*, a book about America's experience with its tax code, and *Germany: The Empire Within*, about German national identity. The Manhattan Institute awards Miss Shlaes its 2009 Hayek Prize for her bestselling book *The Forgotten Man: A New History of the Great Depression*.

STEVE FORBES is the editor-in-chief of *Forbes* magazine as well as president and chief executive officer of its publisher, Forbes Inc. He was a Republican candidate in the U.S. presidential primaries in 1996 and 2000. He served as an economic adviser on taxes, energy, and the budget to John McCain's campaign for the presidency in 2008.

The Manhattan Institute gratefully acknowledges the support of Thomas and Diane Smith, underwriters of the Hayek Prize.

Introduction

by STEVE FORBES

It is a great pleasure to introduce Amity Shlaes, who is a senior fellow at the Council on Foreign Relations and a syndicated columnist for Bloomberg. She writes an occasional column for *Forbes* magazine, which is always the highlight of the issue, and she has written columns for the *Financial Times*. Amity did great work on the editorial board of the *Wall Street Journal*. She has written many books, including one that is dear to my heart, *The Greedy Hand: How Taxes Drive Americans Crazy and What to Do About It*, which is about the American tax code and includes a story about the man who gave us tax withholding. He was an executive at Macy's, and every time I go there, I remember what that store gave us—and I don't just mean the great merchandise.

The Forgotten Man is one in a series of recent books about the Great Depression that conclude that the New Deal did not, in fact, save us. And with this book Amity has reached new heights; because of it, history will likely view her as one of America's most influential writers, on a scale with Thomas Paine, Harriet Beecher Stowe, Ida Tarbell, Upton Sinclair, and even people like Rachel Carson and, certainly, Ayn Rand.

It's not just that the book is about the 1930s; it's the way that Amity writes about the 1930s. It is a narrative but is not just about people and the hardships that they went through during that period. Each person's tale tells its own tale. So she brings economics and politics to life in a way that hasn't really been done before. She deals surely, evocatively, and powerfully with a number of personalities—although apparently Amity has had second thoughts about focusing on Father Divine—selecting people from the 1930s to make various points.

As Amity has pointed out elsewhere, the way that Bill Wilson of Alcoholics Anonymous dealt with the problem of alcoholism is very much with us today, not just in the way people treat alcoholism as an illness but in the way that people try to deal with various other problems in Internet chat rooms. She has a wonderful gift for the telling anecdote. Wendell Willkie's stock has certainly gotten a boost, thanks to Amity Shlaes. His battles with David Lilienthal are told in a way never told before. Andrew Mellon, even with his dour personality, would have been delighted: he comes to life in Amity's hands.

Her book also reveals that FDR was a pessimist. We think of FDR as an ebullient, dominating, warm personality. But in terms of economics and the future growth of this country, he was probably the most optimistic pessimist, to quote Amity, in history (even more so than our current president).

Amity makes her case through the use of narrative and personalities. For example, she tells of a group of people who traveled to the Soviet Union in the 1920s and the ideas that came out of that journey. From her analysis of the ideas that came out of World War I, you get an understanding of what took place in the 1930s. And she demolishes the idea that the New Deal brought America back to economic life and that Roosevelt's optimism gave us the confidence to get through a very tough time, when hardship was simply unavoidable.

The numerous anecdotes in this book include one about a farm out west where a couple of workers suggested ways that they could perform labor-saving work and thus have more resources available to do other things. What was taking place was "electoral politics in the workplace"—and they got fired for suggesting more efficient ways to do things.

The book begins with the horrible tale of a thirteen-year-old who hangs himself because of the Depression. And this was not 1930; it was 1937, the second Depression, the Depression within the Depression. Amity is making the point that even in the late 1930s, we were still mired in hard times. There was no recovery. It never took place.

You read about the New Deal in this book through the story of the Schechter brothers. It is extraordinary how much of a corporatist state we had in the 1930s. So it is not just a book about economics. It is not just about numbers. It brings the whole thing to life. It effectively demolishes all the ideas that we were brought up on about the beneficence of the New Deal and of the Roosevelt administration.

The Obama administration is the last gasp of the New Deal. Even though it is powerful at the moment—although that power is waning—some have the idea that President Obama is a man with fresh new ideas. He doesn't know it, but actually he's a dinosaur—a relic of the 1930s; his mind-set is in 1935. The *Time* magazine cover of Obama as FDR was more telling than even the magazine's publishers knew. They thought of it as a compliment, but when you read Amity's book, you know that it is anything but a compliment.

I'm an optimist. I think that the disastrous things that are being done now are setting the stage for the next book that Amity is writing, which is about the 1920s. That decade turns out to be one of the most fruitful, productive periods in human history. The 1920s have gotten a bad rap because they were followed by the Depression.

We are going to go into a 1920s-style era—in terms of the human spirit being able to rise and innovate again, which can happen only in a free economy, not in the kind of corporatist economy or the kind of uncertain economy that FDR created, even with the best of intentions. We'll give him that—he had the best of intentions. But he created such turbulence and turmoil that capital went on strike and a recovery couldn't take place. It wasn't until after World War II, when nothing much was done by the government, that this country recovered and our natural optimism and sense of innovation—our sense of enterprise—could sink roots again and blossom. Amity, thank you.

The Forgotten Economy: This Recovery and the 1930s

by AMITY SHLAES

This is the hour of Hayek. More than any other, this moment in history reminds us of how right Hayek was that the incremental expansion of government is not benign. No matter what the stock market does, we have a sense that there is something disappointing about the quality of the recovery. The unemployment rate is rising into the double digits. Banks are accumulating excess reserves. Even the rise in the personal savings rate sends a signal of caution—Americans are still holding. Money is still sitting it out, waiting for a sign to enter the market.

Anyone who turns to the Great Depression turns not only to the economy but also to the culture. The culture tells you things about the economy that data points cannot. It matters, for example, that the Philco radios that were popular in those years resembled cathedrals. When Roosevelt's voice came out of them, his economic dictates sounded divine. The radios gave new meaning to the term *ex cathedra*.

In the 1930s, something else came into the living rooms of America: the Monopoly board game. Charles Darrow, the man who laid out the modern Monopoly board, could not at first interest manufacturers in his idea. Parker Brothers actually turned the game down, saying that Monopoly had "fifty-two design errors." Nevertheless, Darrow made his own copies of the game, and in the

mid-1930s, amid the New Deal, Parker Brothers did end up buying Monopoly, which became wildly popular in the Roosevelt years. Imagine people sitting at their card tables playing Monopoly before switching on their cathedral radios to listen to the Fireside Chat. In 1935, the *New York Times* stated: "[L]eading all other 'board games' … is the season's craze, Monopoly, the game of real estate."[1]

I'm going to talk about history in the context of that game. So when I say "monopoly," don't think of antitrust law. Don't even think about what Hayek said about antitrust law. Think of your family in the living room.

You know the game. You are trying to build yourself a certain existence by accumulating houses and hotels. You buy a house, then another house, and when you get a hotel on the property, suddenly the rent revenue goes up. You pat yourself on the back and say, "I'm compounding." On the Monopoly board, you have the small metal tokens, the set figures. There are the rich people, the plutocrats—you know the "top hat" token. Maybe you don't like the top hat. Or maybe you play using the token because you want a chance to become a plutocrat. Or you think that the top hat is good luck. Whatever the reason, Americans have an abiding interest in the top hat and his money—the top hat is one token that has remained in the game even as others have been replaced over the decades.

Your willingness to play the game depends on a few things. It's important to get a predictable number of "Pay Income Tax" cards, though not too many. You can handle these little income-tax blows because you know the amount on the card and you know how many of these cards there are in the deck. It's also important that there be a predictable number of "Go to Jail" cards, though not too many. This is what Frank Knight of the University of Chicago would class as a knowable risk, as opposed to an unknown unknown, or what he called "uncertainty." That there is a predictable number of "Chance" cards matters, too. In other words, you require some certainty that you really own what you think you own and that the risks to your property can be reckoned.

Some of us play ruthlessly. For us, there is no point in playing unless we get a shot at being that winner who takes all and gets his own monopoly. Others—most

people—play Monopoly not to triumph but for the company of the ruthless party, to get along respectably, or to situate themselves in a community. All they hope for is that they don't come in last.

What else matters? The temperament of the bank. The rules for that player's job are written out in the directions. There is a fixed supply of Monopoly money. Ideally, the bank follows those rules and allows itself little or no discretion. As Hayek said, some social services are acceptable as long as they are prescribed. But we have all had the experience of sitting down at the table to discover a bank that overreaches. Players know what they require in a bank. The bank does not have to be perfect. The bank just has to be *not too bad*. If the bank is too unpredictable, too discretionary, too jumpy, you know what happens: players walk away from the board. There is no game.

When it comes to the Great Depression, we know the traditional narrative. The stock-market crash generated an economic Katrina. The sitting president responded with preposterous inadequacy to this perfect storm. During the earlier years of the Depression, one in four Americans was unemployed. The Depression was a crisis of confidence, a result of some combination of monetary, banking, credit, and international factors. The terrible thing was the duration of the unemployment, which averaged in the mid-teens for the entire decade of the 1930s.

The second thing we learned from the traditional narrative was that the Depression was mysterious—a topic for experts with doctorates. Great brains were needed to end it, minds a standard deviation or two out there, with superb credentials. The message was that government brains were smarter than average brains. That was why FDR's advisory group was called the Brains Trust: Felix Frankfurter, Frances Perkins, Stuart Chase, George Warren, Marriner Eccles, Adolf Berle. The mystery had something to do with a shortage of money that only a prince of the economics kingdom could understand. Their tinkering with money saved us, and only they could have done it.

There were corollaries to the traditional narrative. In the New Deal, government knew more than big business. And big business knew more than small business. The small player at the board? He was almost irrelevant.

We have internalized other presumptions about the period. One is that cleaning up Wall Street by getting rid of white-collar criminals helped the nation toward recovery. Remove the top hats and you level society in a way that is good economics. FDR, in fact, said that his wealthy critics reminded him of the man wearing his tuxedo and top hat who fell into the water but was saved from drowning when someone pulled him back on shore—after which the man began complaining that he had lost his top hat.

In this period, we were taught, property rights may have mattered, but they mattered less than a lot of other things—the social good, job creation, shoring up homeowners, and getting the money supply right. Property rights were appropriately subordinated to the macroeconomic crisis. The last part of the traditional story is that American democracy was endangered—that Sinclair Lewis was wise to warn of the rise of dictators in his play *It Can't Happen Here*. Therefore—or so the reasoning goes—the Wagner Act, the great labor law, was a good thing or, at the very least, a lesser evil. Organized labor was said to be a benign force in the economy and, in any case, exhilarating to learn about. There was a theatrical energy to the CIO's John L. Lewis that historians and teachers both have found appealing. There was an element of satisfaction to thinking that here in the United States we were experiencing our own tame Petrograds. Sit-down strikes? Those were adolescent capers of young industrial America.

Finally, we assume something about the tempo of it all: the traditional view of the 1930s is that action by the government was good and inaction was fatal. We always told ourselves that there is something about a deflationary spiral that mandates any kind of action, even action far removed from strict monetary management. Somebody had to do something, we thought. In 1933, the humorist Will Rogers wrote that if Roosevelt had "burned down the capital, we would cheer and say, 'Well, at least we got a fire started, anyhow.' "[2] Keynesianism works as the window dressing for that because more than it is about multipliers or demand, Keynesianism is about furious activity.

So that's the official version. Or, to put it in the terms of the Monopoly board: in the 1930s, America was failing because we had no bank. There was nobody to lead at the table and hand out the Monopoly money. We had too many top

hats lording it about on the board, trying to establish a plutocratic monopoly, a plutocracy. We needed a strong, credentialed bank, and FDR materialized to be that bank. After his appearance, Americans were on their way to having a shot at building a little wealth.

When you go back to research the period, however, you find a different story. It starts the same: the early part of the Depression, the years upon which economists have focused, was indeed a Katrina. Credit, banking, monetary policy, and international components all combined to create that first dark period that was so well studied by our forerunners. A number of the New Deal measures provided lasting benefit for the economy, just as the traditional history holds. Here one must certainly count the creation of the Securities and Exchange Commission, as the Manhattan Institute's Nicole Gelinas notes in her recent book, *After the Fall*; the push for free trade led by Secretary of State Cordell Hull; and the establishment of the modern mortgage format. Should we include deposit insurance on this list of benefits? Maybe. Maybe not.

But the rest of the evidence contradicts the official narrative. After two or three years of research, I discerned one big theme: government prevented recovery. Herbert Hoover was too active—not too passive, as the old stereotypes suggest. Roosevelt and his New Deal impeded recovery as well. This was especially true in the latter half of the 1930s, where even all the traditional explanations—monetary, banking, international—just don't suffice. You can find individual snapshots of growth during the Roosevelt years, and they are as impressive as the stock-market rally of the past year has been—impressive because they represent a leap from that tiny, terrifying base. But then, as now, we define recovery as something simple—getting back to where we were before, whether it is 1929, 2000, or 2007. By that measure, the New Deal was a calculus of frustration, yielding the always recovering, but never recovered, economy.

The government did its damage by practicing arrogance: by talking down to the citizen and by compromising that citizen's economic autonomy. In addition, policymakers forgot microeconomics and common sense. Instead, they became dazzled by macroeconomics. The Roosevelt administration wrongly emphasized executive-branch discretion rather than the rule of law. A final factor, too little

discussed, in the severity of the Great Depression was the systematic undermining of property rights.

Let's start with the arrogance, which is the arrogance of planning, or "scientism," that Hayek also identified. The centerpiece of the New Deal's first hundred days was the National Recovery Administration. The goal of the NRA in 1935 was more ambitious than, say, that of the health-care legislation of 2009: for government to join with big business in supervising the industrial economy. Imagine an enormous multi-sector mechanism calibrated to monitor, and even to set, prices. The principles upon which the NRA codes were based were popular with scholars at the time. Prices had to be pushed up to make recovery possible. Big firms in industry—the ones that were "too big too fail"—were supposed to write codes for all firms in their sector, big and small. Naturally, this worked to the advantage of the larger firms. That's one reason that the name of Monopoly resonated as it did in 1935 or 1936.

Another NRA principle was that competition inhibited recovery by driving prices down. New Dealers carried on a passionate romance with the concept of the economy of scale. If something was bigger, they believed, it was more efficient. So size was supposed to speed recovery, too. Consumer choice? Choice was inefficient, and thus inhibited recovery.

The absurdity of these principles was overlooked because the principles came from great minds. One Brains Trust member, Raymond Moley, described the general attitude of the Roosevelt administration. He sought to capture the myopic credentialism of another man in the Brains Trust, Felix Frankfurter:

> The problems of economic life were to Frankfurter matters to be settled in a law office, a courtroom, or around a big labor-management bargaining table. These problems were litigious, controversial, not broadly constructive and evolutionary. The government was the protagonist. Its agents were its lawyers and commissioners. The antagonists were big corporate lawyers. In the background were misty principals whom Frankfurter never really knew at first hand and who were chiefly envisaged as concepts in legalistic fencing. These background figures were owners of the corporations, managers, workers, and consumers.[3]

What Moley is saying is that in this period there weren't merely forgotten men. There was also a forgotten economy.

One family that was targeted by such officials was the Schechters, wholesale chicken butchers from Brooklyn. To read their testimony is to hear small businessmen think aloud. Against their own better judgment, the Schechters were trying to convince themselves that they ought to comply with the National Recovery Administration. The NRA code that applied to them had a name that, in and of itself, amounted to a bureaucratic obstacle: the Code of Fair Competition for the Live Poultry Industry of the Metropolitan Area in and about the City of New York. The Schechters did all the wrong things. They ignored federal mandates. They paid their staff butchers less than rules said they should. They charged prices that were deemed suspiciously low. They competed. They allowed consumers to pick their own chickens. The Schechters were prosecuted for violating the NRA. The contention on the part of the Justice Department in court was that the Schechters, and others in their business, did this because they lacked the education to know what was right.

The prosecution of the Schechters seemed comical but was actually tragic. If you imagine the courtroom scene, on the one side you see Walter Lyman Rice, from the government and a graduate of Harvard Law School. On the other side is a small man in the poultry trade, Louis Spatz, who is afraid of going to jail for doing the things he did. So Spatz is trying to defend his actions. He barely speaks English. The prosecutor isn't letting him defend himself, even though Spatz is accurate about the way business works.

> Rice: But you do not claim to be an expert?
> Spatz: No.
> Rice: On the competitive practices in the live poultry industry?
> Spatz: I would want to get paid if I was an expert.
> Rice: You are not an expert!
> Spatz: I am experienced but not an expert.

This exchange came later:

> Rice: You have not studied agricultural economics?
> Spatz: No, sir.

Rice: Or any sort of economics?
Spatz: No, sir.
Rice: What is your education?
Spatz: None; very little.
Rice: None at all?
Spatz: Very little.

At one point, this everyman, this small player, sort of pulls himself together.

Rice: And you would not endeavor to explain economic consequences of competitive practices?
Spatz: In my business, I am the best economist.
Rice: What is that?
Spatz: In my business, I am the best economizer.
Rice: You are the best economizer?
Spatz: Yes, without figuring.
Rice: I wish to have that word spelled in the minutes, just as he stated it.
Spatz: I do not know how to spell.

Why does this dialogue matter? Because, in fact, little businesses like Schechter Poultry were the natural drivers of recovery, and they weren't being allowed to do that driving, to accumulate wealth, to get to the sweet point of sliding a house onto their property square. Instead, they were sidelined. The Schechters won their case in the Supreme Court—the landmark "Sick Chicken Case" of 1935. But the combined challenges of the lawsuit and the Depression did terrible damage to their business.

To address the monetary question: clearly, there wasn't enough money around in the early 1930s. (Some towns made their own scrip. One—Albion, Michigan—actually put an image of FDR's head on its makeshift currency.) Roosevelt was therefore not wrong in seeking to reflate. But though Roosevelt's direction was all right, the discretionary aspect of his policy was terrifying. As Henry Morgenthau reports in his diaries, prices were personally set by the president. Indeed, if you go back to the 1930s, you see FDR taking us off the gold standard in April 1933. By autumn, he is sitting up in bed every morning,

after his egg, say, and before his cigarette, setting the gold price. Let it go up twenty-one cents, he would say. Morgenthau would ask, why twenty-one cents? Because, Roosevelt would reply, twenty-one is seven times three, and three is a lucky number. "If anyone knew how we set the gold price," wrote Morgenthau in his diary, "they would be frightened." Because for so long we approved of the direction of Roosevelt's monetary policy, we forgot to ask whether his discretion mattered. It did. When Roosevelt undertook the gold experiment, the Roosevelt rally halted in its tracks.

What about our other received ideas, such as faith in the notion that cleaning up Wall Street was a net benefit? When you look at the period, you see that the actions that the White House, the Justice Department, and the SEC took against Wall Street did, on balance, more damage than good. Remember, the rhetoric then was harsher than ours is today. They didn't just talk about money-changers; they slammed the wealthy as "princes of property." In 1937, after his landslide reelection, Roosevelt delivered an inaugural address that presidential adviser Larry Summers would never let President Obama put up on the teleprompter. Roosevelt said that in government, we seek an instrument of "unimagined power" to fashion a higher order of things. This caused businesses to freeze in their tracks. Companies went on what Roosevelt's crowd resentfully termed a "strike of capital."

The capital strikers mattered because they were as important, perhaps even more important, to recovery as the Schechter types. They are the ones who play to kill, who aim to clean up at the Monopoly board. Alfred Lee Loomis of Tuxedo Park, New York, was an example of this spirit. Loomis had the kind of mind that contributes significantly to GDP. During World War I, he had improved the design of firearms for the U.S. Army. In the 1920s, Loomis became wealthy through his work as an investment banker. He was developing a new form of utility company that might finally be able to marshal the capital necessary to light up the American South. But when Loomis saw that the new administration was hauling utilities executives down to Washington for hearings, he shut down his business and retreated to his Tudor house to run a kind of private think tank for his own benefit.

What's interesting is that it didn't take a big audit or an indictment to make Loomis absent himself. All it took was a suggestion of diminished return—less

property. And the suggestion that he might have to show up at a hearing. That was enough to make him deprive the economy of his talent. In other words, all these years we have heard about a labor surfeit during the Depression; but one can make the counterargument that there actually was a shortage of talent in the 1930s.

Taxes posed another challenge to the economy. A review suggests that the New Deal tax increases weren't worth whatever socially equalizing effect they were intended to produce. That is because they did damage by simply taking away too much property from citizens and companies. So as the years wore on, businesses no longer saw a need to proceed. In the later 1930s, a banker, Leonard Ayres of the Cleveland Trust Company, pointed out in the *New York Times* that "for nearly a decade now the great majority of corporations have been losing money instead of making it."[4]

In October 1937, the *New York Times* reported a speech by W. O'Neil, president of General Tire and Rubber Company, that captured the mood. "The very large capitalist is on a strike because he is faced with an 80 percent tax on his profits on stocks, which is not subject to deduction for subsequent losses," said O'Neil. The small-time capitalist, he added, "is on strike, too. He will not build the house that he needs, and there are many thousands like him in the United States."[5]

Regarding big labor, what might have seemed romantic was also destructive. We tend to forget it, but the Wagner Act of 1935 was a tiger of a law. The Taft-Hartley Act, the edited version that came after World War II, was a pussycat by comparison. The 1935 act suggested the possibility of terrifying changes at factories. One was the closed shop—nonunion members need not apply. The other was the sit-down strike, literally a threat to the basic property right of factory owners: the right to close their doors when they felt like it.

The Wagner Act gave unions the related power to demand higher wages. And they did. If you look at a chart of wages in the twentieth century, you will see something counterintuitive: real wages in the 1930s were actually higher than in the rest of the century. This is a perverse phenomenon in a period when the economy was so down. The result was good jobs for a few and high unemployment for the rest. Some of the economic work on this has been done

by two scholars: Lee Ohanian of UCLA and Harold Cole of the University of Pennsylvania. But the reality of overpriced labor is evident in the phrases about the Great Depression that we grew up with: "It was all right if you had a job"; "Nice work if you can get it."

"Nice work" was actually the refrain of a song from a 1937 Fred Astaire film released at the zenith of union power. Recoveries make a choice. This recovery chose to stay away. So went 1936, 1937, 1938, 1939—as the decade wore on, the rally of the early years fizzled.

In short, the problem with the great game board of the 1930s was not that there was no bank. It was that there was *too much* bank, in the form of the federal government. The bank was worse than "not too bad." The bank was terrible. It fooled around with the money. It was too aggressive. It was arbitrary. It took advantage of its bank status to make itself the most powerful player. It shoved everyone else aside so that it could monopolize.

Benjamin Anderson, at the time an economist with the Chase National Bank, summed up his book about the period thusly: "Preceding chapters have explained the great depression of 1930–1939 as due to the efforts of the governments, and very especially the Government of the United States, to play God."[6]

It is not hard to see some of today's troubles as repeats of the errors made during the 1930s, from the arrogance up top to the idea that we can fashion a useful reform—in the current instance, a health-insurance reform—if only we can craft the details of that reform correctly. Now, as then, we have a federal government that is dilettantish with money—think of both the Bush and Obama dollar policies. Finally, our current government recalls the government of the 1930s in its disregard for other involved parties, whom it views, in those words of Raymond Moley, merely as "misty principals."

Property rights are also key to our long-term recovery. They suffer in several ways these days. We can say that the mortgage crisis was brought about by a lengthy erosion of property rights, first by Fannie Mae and Freddie Mac, but also by the Federal Reserve. Expanding upon theories espoused by FDR, Congress

taught the country that homeownership was an entitlement. This fostered a misunderstanding of what property actually is. Homeowners didn't realize what ownership entailed, that is, exactly what the terms of their mortgage contracts obligated them to deliver. In our bipartisan enthusiasm for making everyone an owner, we debased the concept of homeownership. And we continue to debase it—through cramdowns, for example.

Next, property rights are endangered by the general assault on contracts. The proximate example of this is the disregard for creditor rights in the rescue packages for big automakers. The current administration made a political decision to subordinate the bondholders' contracts to union demands. In not following precedent and emphasizing the cleverness of their own bankruptcy architecture, the framers of the Chrysler deal forgot one big thing. The bankruptcy process that denies a creditor his expected return makes credit dearer next time around—or scarcely available at all. The signal for the future: U.S. bonds are not trustworthy.

Three other threats to property rights loom. One is tax increases. When we talk of confiscatory taxes, we are saying something vague, but what matters is the literal meaning: more taxes means less property.

Abuse of eminent-domain powers is the second looming threat to property rights. The next stimulus law is likely to emphasize infrastructure—railroads, roads for automobiles—and because of what has become known as the *Kelo* case, and cases like it, the federal government will have enormous license to use eminent domain to claim property. We can think of other erosions—intellectual property that will be lost in the formularies of the federal government that favor generic drugs.

Then there is inflation: the third, and perhaps the greatest, threat to property rights. Inflation is the ultimate confiscation.

This relentless emphasis on property rights may seem odd. After all, some might say, we don't need to talk about property rights, since they are taken for granted. No one ever said that property rights weren't important. The problem is, we simply didn't put them first. Saying "property rights" sounds selfish. It

has been easier to say "social equity," "ownership society," or "rule of law" and to let property rights become an afterthought, a given.

But the experience of the Great Depression suggests that the protection of property rights is crucial to recoveries and that their erosion precludes recoveries. That's why the board-game analogy is worthwhile. The board game reminds us that economic growth isn't merely about animal spirits. It is about the impulse of the small man, and the entrepreneur along with him, to start again. As the *Times* said so long ago, what matters is "real estate."[7] The moment has come for all of us to devote resources to the defense of property rights.

It is wrong to spread too much gloom here—even at an event named after Friedrich August von Hayek. The federal incursion here and now is certainly no greater than what Britain saw with the nationalizations of Clement Attlee and his Labour Party in the 1940s. And it is important to remember that on this subject, Hayek was wrong. England did not become a dictatorship. It became more open, and eventually it got Margaret Thatcher. As for the United States, we don't need a perfect government or a perfect economy. We don't need a perfect bank. We just need one that is "not too bad." Then individual players will come back. The main thing to remember is that recovery doesn't happen because of a reform from the top. It happens down here on the board, one hotel at a time.

Endnotes

[1] "New Games for Parlor," *New York Times*, November 24, 1935.

[2] Quoted in Ben Yagoda, *Will Rogers: A Biography* (New York: Knopf, 1993), 302.

[3] Raymond Moley, *27 Masters of Politics* (New York: Funk and Wagnalls Co., 1949).

[4] "Wages and Profits," *New York Times*, December 24, 1938.

[5] "Capital Strike Laid to Laws," *New York Times*, October 23, 1937.

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