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America's Return to a Road to Serfdom?

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Under the cover of one of the most severe economic crisis in the post-World War II period, the United States is witnessing the largest and most dramatic increase in the size and scope of government power since the 1930s and 1940s.

We are dangerously returning to "the road to serfdom" that free market, Austrian economist and Nobel Laureate, Friedrich A. Hayek, warned about in a book with that title that was originally published in 1944. A spider's web of regulations, controls, and commands were imposed on the free-enterprise system at that time, first under the crisis conditions of the Great Depression and then expanded in Great Britain and the United States during the emergency years of the Second World War.

Hayek feared that with this growth in government control over the economic affairs of the nation, individual freedom was being seriously threatened. He argued that with government commands over production, pricing, and resource use there inevitably came government control over peoples' lives.

"WE, THE PEOPLE," OR GOVERNMENT CONTROL

The vital issue, Hayek insisted, is whether "we, the people" decide what shall be produced and for what purposes based on what we think goods and resources are worth through the free interplay of supply and demand in a competitive free market; or whether it shall be those in political power who will increasingly dictate through those commands, controls, and planning regulations what we, the citizens of the country, should have available to use and consume, in what quantities and qualities, for what purposes, and at what costs.

At least in America and some other Western nations, Hayek's warning was partly heeded. Neither the United States nor the rest of the Western world ever fully reversed the extent to which governments had grown in size and intrusiveness in the 1930s and 1940s. But they did step back and did not follow either Nazi Germany or the Soviet Union all the way down that road to serfdom under which individual freedom is completely crushed and each human being is reduced to a mere expendable cog in the wheel of state planning and power.

Unfortunately, over the decades since the Second World War, Western governments have continued to incrementally encroach on people's liberty through the expansion of the Interventionist-Welfare State. Taxes have increased, regulatory powers have expanded, and redistributive programs have grown so much that many in America and Europe truly believe that they have an "entitlement" to other people's income and wealth.

ECONOMIC CRISIS AND MASSIVELY GROWING GOVERNMENT

But it is under the cover of the current economic crisis, that this growth in government power and control is accelerating at a gravely dangerous pace. If this trend is not halted, we once again seem headed down that road to serfdom about which Hayek warned more than six decades ago.

Starting in 2008, "Big Brother" in Washington has been pouring hundreds of billions of dollars into various sectors of the U.S. economy. With these dollars have come more and more government control and influence over the private enterprise system.

In the autumn of 2008, the Bush Administration decided to spend nearly $700 billion in the American financial sector to prop up banks and other lending institutions facing either insolvency or in some cases bankruptcy, under the argument these corporations were "too big to fail." In exchange for these vast sums of bailout money, the U. S. Treasury took partial stock ownership over many of the leading banks and financial institutions in the United States.

Now, under the guise of being the steward of the taxpayers' money, the Obama Administration has appointed a "pay czar" who has been imposing wage controls on the salaries to be received by senior executives employed in these financial institutions.

In addition, the regulatory reach of the Federal government and the Federal Reserve System is being extended to more closely oversee and determine the types of risk management and lending strategies banks and investment houses may be allowed to follow in the years ahead. The capital markets of America are threatened with even far more politicization of investment decision-making than has been the case in the past.

More than $80 billion of taxpayers' money has been spent in an attempt to prop up the declining American automobile industry. In the process, ownership over General Motors has been turned over to the United Auto Workers Union, with Uncle Sam as a powerful voice in the background influencing the future technology and production direction of the American auto manufacturing. After three Washington bailouts, now, since the 1970s, Chrysler has been merged with Fiat, with the government still serving as a backseat driver.

The $820 billion cap-and-trade bill wanted by the Obama administration would basically nationalize the entire atmosphere over the United States, with the government selling and assigning permits dictating the amount of emissions that may be associated with every type of manufacturing in the U.S. With this power, those in political authority in Washington can determine not only the technologies with which every private enterprise in America can undertake any form of production, but will be able to decide who will be allowed to stay in business, as well as what they produce and for what purpose.

It will represent a crushing stranglehold over all of the county's industry that will also be extremely expensive for the buying public. It has been estimated that within a decade or so, the higher costs of manufacturing due to cap-and-trade will raise by at least $3,000 a year the consumption expenditures of the average American household.

And to top all of this off, the Congress is now in the process of very well passing what will amount to the virtual nationalization of the entire health care industry in America. The government will dictate even more comprehensively than it already does the medical fees and treatments that will be available to every single American citizen. The price tag for having this dubious government bedside manner is estimated to be around $1 trillion and rising over the next decade.

There will be government rationing of a widening circle of medical services and facilities. There will be increasing government regulatory controls over the availability of pharmaceuticals for various diagnosed diseases. There will be political determination of who lives and who dies based on government actuarial judgments concerning the elderly, the young, and the chronically ill. It will not be patients and their doctors who will have the greatest influence and control over this most personal and intimate matter. Rather, it will be pressure group politics and expected voting patterns in upcoming election days that will determine what a particular life is worth in terms of government dollars allocated out of the Federal budget.

HUMAN DIVERSITY OR GOVERNMENT-IMPOSED UNIFORMITY

The essence of a free-enterprise society is that each individual has the personal liberty to determine his own goals, weigh the costs of achieving the various ends he values, and make the personal trade offs that he considers worthwhile, given what he would like to do so his life has meaning and fulfillment.

But as Hayek also warned many years ago, as the government takes over control of more and more aspects of our life the more we are confined within and made to conform to the hierarchy of values and goals that the political authorities are determined to impose on each and every one of us. By taxing our income and wealth, and by dictating what may be produced and to whom it will be supplied, the government reduces the members of society to a homogeneous mass made to fit the mold that the political elite thinks is best for us.

Gone is the diversity and pluralism of human difference that is usually considered one of the hallmarks and benefits of the open and free society. We all become interchangeable parts of an economic plan designed by others to reflect their conception of "fairness" and "social justice." The death of individual liberty is the end point of our new road to serfdom under which we are reduced to subservient and obedient subjects of our political masters.

THE RATIONALITY OF THE MARKET VS. GOVERNMENT CHAOS

There is another equally dangerous dimension to this growth in government and the resulting destruction of economic liberty and the free market: the loss of any rationality to the working of the country's entire economic system. As Hayek and his fellow Austrian economist, Ludwig von Mises, cogently argued, without a competitive pricing system based on the free play of supply and demand, there is no way of knowing whether the scarce resource of the society are being utilized in the most economically efficient manner.

Market-based prices serve as the information steering mechanism to determine how resources, labor, and capital should be allocated among all the alternative and competing uses for which they may be applied to manufacture desired goods and services.

President Obama's "pay czar" has dictated the maximum cash salaries that may be paid to senior executives in the part of the financial sector in which the government has a stake. This means that the use of executive talent will be irrationally employed in this part of the economy. Unless people may freely convey on the market what they think someone's abilities and talents are worth as expressed in the wage they are willing to pay that person to perform a valuable service, the right people will not be performing the right job in the right place. There will be mismatches between work to be done and the best person assigned in the market to get it accomplished.

Now extrapolate that to the entire economy and the use all types of labor, land, resources, and capital equipment. The government will then be mandating, manipulating, and distorting the pricing system though controls, regulations, and artificial subsidies for more and more of all the things people want in society, whether it be health care, automobiles, a functioning financial sector, or all types of manufactured goods.

The end result is a dysfunctional economy with growing waste, inefficiency, and imbalances between supplies and demands for the various goods and services desired by all of us as income earners and consumers. The profit motive is undermined, the incentive for innovation is weakened, and improvements in material prosperity are slowed down and in the extreme, finally may grind to a halt.

Prices have work to do. When government commands and controls replace the free price system generated by peaceful market competition, people not only find themselves reduced to a new form of serfdom but discover they are living in a world that Ludwig von Mises once called politically created "planned chaos."

This is a very high price to pay for the false promises of political paternalism and the illusionary security of the welfare state. Liberty and prosperity are too precious to trade away even during the emotional times of economic crisis and uncertainty.

Our task must be to reason with our fellow Americans before we have traveled so far down that new road to serfdom that it becomes almost impossible to turn back.

The Menace and the Immorality of the Welfare State

by Dr. Richard M. Ebeling

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In the United States policies are being promulgated by those with political power in Washington, D. C. that will involve a massive and dangerous growth in the size and scope of government. At the core of the Obama administration's push for implementing a comprehensive national health care system and related programs is a radical ideological belief in political paternalism and the welfare state.

In the face of the euphoria of those demanding such a huge expansion of "Big Brother" over even more of our lives, it is worthwhile reminding ourselves of the premises behind and the realities of welfare statism.

POWER AND PATERNALISM

First and foremost, the guiding idea behind political paternalism is that the individual cannot be trusted to be a free and responsible human being. Those who wish to socially engineer our lives consider us too ignorant, too irresponsible, and too narrow in our own personal planning horizons to intelligently and reasonably take care of our own health care, our own retirement, our own family's education, or our own spending and consumption choices.

These political paternalists who are proposing to enlarge the agenda of the welfare state implicitly consider themselves superior to the rest of us. With arrogance and immeasurable hubris, they presume to know what is good for us, better than we know ourselves. They are nothing less than would-be tyrants and despots determined to make the world over in their own ideological image—and, of course, all for our own good, whether we want it or not.

In addition, they are willing to use force against their fellow human beings to attain their paternalistic ends. That is, they believe that it is morally right for the state to use its coercive powers to take the income and wealth of some to give to others.

If an innocent citizen were to resist having his income and wealth redistributed, the paternalists clearly believe that the state has the right to even kill him (since the police agents of the state have the legitimized authority to use lethal force against those who resist its power) so someone else can have his or her food stamps, or public housing apartment, or the government pay their visit to the doctor's office.

If this seems like an "extreme" or an exaggerated statement, see how the government will react if on the day your income taxes are due you inform the tax authority that you are sending in a tax payment to pay your contribution for police, courts, and national defense, but you're withholding any amount that would fund a national health care plan because you consider it unnecessary and immoral. You soon may be facing jail time or physical harm if you resist their confiscatory seizure of your property for unpaid taxes.

POLITICAL PLUNDER

Second, a number of economists, such as Nobel Laureate, James Buchanan, have taught us that the actual politics of government intervention and redistribution has little to do with high-minded notions concerning some hypothetical "public good" or "general interest." The reality of democratic politics is that politicians want campaign contributions and votes to be elected and reelected, and they offer in exchange other people's money. Those who supply those campaign contributions and votes want the money of those others, which they are not able to honestly earn through the free play of open competition in the market place.

The bias in the democratic process toward political plunder is due to what is called a "concentration of benefits and a diffusion of burdens" that results from various government interventions. Suppose that in a country of 30 million people, the government taxes each citizen $1, and then redistributes that $30 million among a special interest group of 30 individuals. Each taxpayer will have one extra dollar taken away from them by the government for the year, while each of the 30 recipients of this wealth transfer will gain an extra $1 million.

The 30 recipients will collectively have a strong incentive to lobby, influence and even corruptly "buy" the votes of the politicians able to pass this redistributive legislation. Each individual taxpayer, on the other hand, will have little incentive to spend the time and effort to counter-lobby, influence, and petition members of the legislature merely to save $1 off his or her annual tax bill.

Thus, modern democracy has degenerated into a system of political plunder and special privilege at the expense of consumers, taxpayers, and competing producers in society.

THE MIRAGE OF SOCIAL JUSTICE

Third, as another Nobel Prize-winning economist, Friedrich A. Hayek, persuasively argued, even if we assumed that the political paternalists have the most benevolent motives in mind, there is no real meaning to ideas such as "social justice" or politically enforced "fairness." They are all "mirages," Hayek warned. The market does not reward some hypothetical notion of "merit" or "goodness." The market rewards "service," i.e., did an individual succeed in offering to others some specialized product in the market system of division of labor that was valued by those others who were willing to pay a particular price for it?

There is, in fact, no objective measure of an individual's "real merit" or "worth" or "need," and therefore there is no impartial and unbiased way the state can bestow on each member of society some fraction of national income that reflects their "socially just" and deserved amount.

Hence, it is far better to leave such issues to the private-sector charity of individuals and voluntary associations, who in spending their own money, will do so based on their own evaluation of who may or may not deserve charitable support guided by their own personal standards of benevolence.

Plus, private charity, precisely because it relies on voluntary contributions, is far more efficient in their tasks than the coercive monopoly welfare state. Why? Because private charities must demonstrate to their voluntary supporters that their dollars have been spent effectively; otherwise, their support diminishes over time in competition with other charities and other uses the donors have for their own money.

MORAL HAZARD

Fourth, the welfare state produces over time perverse incentives and behavior among the members of society. Economists call this "moral hazard." If the costs and consequences of someone's mistakes and bad judgment are paid for and subsidized by others, then the person making those mistakes or acts of bad judgment has no incentive to learn from his mistakes and act more carefully and wisely in the future. Thus, you create an incentive for such individuals to do the same thoughtless or reckless actions again in the future. Plus, you signal to others in society that they, too, can act in the same irresponsible ways, and have someone else—the taxpayer—pick up the tab for their mistakes in the future, as well.

Because of earlier government bailouts, the "too big to fail" financial institutions on Wall Street believed they could act recklessly with their depositors' and investors' money, because they were confident (and have been right for the most part) that government would bail them out, also, if their "creative" investment strategies were to turn into big losses.

If individuals expect the government to plan for their old age, provide their healthcare needs, oversee the education of their children, guarantee them a job, monitor what they eat, drink, watch, and read, as well as cover their losses from bad decisions, then why or how shall those individuals ever learn or be motivated to be more self-responsible in these and related affairs of everyday life? This does not make for a healthy and productive society in the longer run.

GOVERNMENT DEFICITS AND GROWING DEBT

Fifth, an expanding welfare state generates growing financial demands on the regulatory and redistributive powers of the state. With no "fiscal constitution" imposing a balanced budget or other limits on the expenditures of the government, modern democratic society has plunged further and further into deficit spending and mounting government debt. We are right now witnessing that government debt grow by the trillions of dollars.

Government debt is a lien on citizens' income in the future, since the principle and interest are supposed to be paid off at some point as the government's IOUs come due. Thus today's deficits mean higher taxes or even more government borrowing tomorrow to at least pay the growing interest on that accumulated debt.

But we also need to remember that we pay for that deficit spending not only tomorrow when the borrowed sums and interest payments are supposed to be paid. We pay for it in the present, as well. Every dollar borrowed today by the government siphons off a dollar that, otherwise, would have been available for private sector investment and use. The society's resources are finite at any moment in time. Those scarce resources are used either by individuals in the private sector or by those running the government. They cannot be used by both of these potential users at the same time.

Thus, every dollar borrowed by the government today (and the real resources that dollar's purchasing power represents in the market place) is a dollar not being used for, say, capital formation, technological innovation, or improvements in private sector job skills so workers may earn higher wages in the future.

Instead, that dollar (and the real resources it represents) is used by government for current consumption: government employee salaries, welfare payments, or the fuel to fly the president's "Air Force One."

As a result, we are that much poorer as a society due to those resources being used for current consumption rather than future-oriented capital formation for higher and better standards of living tomorrow.

THE NEW ROAD TO SERFDOM

All of these factors, and others that could be listed, show the menace and the immorality of the welfare state. The welfare state has been and will continue to lead us down a dangerous new "road to serfdom" in which our lives are more and more controlled, managed and manipulated by those in political power who claim the right to dictate how we are to live and work.

It encapsulates an evil immorality in which political force continues to claim the authority to deny us our individual rights to life, liberty, and honest acquired property. The interventionist-welfare state has been creating a new feudalism with political and special interest elites who serve as the "lords" who rule over and ruin the rest of us, the modern serfs who are expected to toil for their benefit under strangling regulations, burdensome taxes, and most likely worsening inflation as the years go by.

All of us who prefer to be free men in a free society with a free market need to do all in our intellectual power to stop and reverse this reactionary counter-revolution against the ideal of human liberty. Otherwise, our civilization may be heading for a terrible collapse that will leave nothing but tyranny and poverty for generations to come.

Market Interest Rates Need to Tell the Truth, or Why Federal Reserve Policy Tells Lies

by Dr. Richard M. Ebeling

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On December 16, 2009, the Federal Reserve Open Market Committee announced that it was planning to maintain a Federal Funds rate between zero and a quarter of a percentage point. The Committee said that it would keep interest rates "exceptionally low" for an "extended period."

Arguing that there was no reason to fear significant price inflation for the foreseeable future, the Open Market Committee also said that it was continuing to inject more Federal Reserve-created money into the financial markets as it finishes buying up by the end of March 2010 a total of more than $1.5 trillion in mortgage-backed securities and related debt held on the books of Fannie Mae and Freddie Mac.

Virtually all commentaries about the Fed's announced policies focus on whether it is too soon for the Federal Reserve to raise interest rates given the state of the economy, or whether the Fed should already be raising interest rates to prevent future price inflation.

What is being ignored is the more fundamental question of whether the Fed should be attempting to set or influence interest rates in the market. The presumption is that it is both legitimate and desirable for central banks to manipulate a market price, in this case the price of borrowing and lending. The only disagreements among the analysts and commentators are over whether the central banks should keep interest rates low or nudge them up and if so by how much.

MARKET-BASED INTEREST RATES HAVE WORK TO DO

In the free market, interest rates perform the same functions as all other prices: to provide information to market participants; to serve as an incentive mechanism for buyers and sellers; and to bring market supply and demand into balance. Market prices convey information about what goods consumers want and what it would cost for producers to bring those goods to the market. Market prices serve as an incentive for producers to supply more of a good when the price goes up and to supply less when the price goes down; similarly, a lower or higher price influences consumers to buy more or less of a good. And, finally, the movement of a market price, by stimulating more or less demand and supply, tends to bring the two sides of the market into balance.

Market rates of interest balance the actions and decisions of borrowers (investors) and lenders (savers) just as the prices of shoes, hats, or bananas balance the activities of the suppliers and demanders of those goods. This assures, on the one hand, that resources that are not being used to produce consumer goods are available for future-oriented investment, and, on the other, that investment doesn't outrun the saved resources available to support it.

Interest rates higher than those that would balance saving with investment stimulate more saving than investors are willing to borrow, and interest rates below that balancing point stimulate more borrowing than savers are willing to supply.

There is one crucial difference, however, between the price of any other good that is pushed below that balancing point and interest rates being set below that point. If the price of hats, for example, is below the balancing point, the result is a shortage; that is, suppliers offer fewer hats than the number consumers are willing to buy at that price. Some consumers, therefore, will have to leave the market disappointed, without a hat in hand.

CENTRAL BANK-CAUSED IMBALANCES AND DISTORTIONS

In contrast, in the market for borrowing and lending the Federal Reserve pushes interest rates below the point at which the market would have set them by increasing the supply of money on the loan market. Even though savers are not willing to supply more of their income for investors to borrow, the central bank provides the required funds by creating them out of thin air and making them available to banks for loans to investors. Investment spending now exceeds the amount of savings available to support the projects undertaken.

Investors who borrow the newly created money spend it to hire or purchase more resources, and their extra spending eventually starts putting upward pressure on prices. At the same time, more resources and workers are attracted to these new investment projects and away from other market activities.

The twin result of the Federal Reserve's increase in the money supply, which pushes interest rates below that market-balancing point, is an emerging price inflation and an initial investment boom, both of which are unsustainable in the long run. Price inflation is unsustainable because it inescapably reduces the value of the money in everyone's pockets, and threatens over time to undermine trust in the monetary system.

The boom is unsustainable because the imbalance between savings and investment will eventually necessitate a market correction when it is discovered that the resources available are not enough to produce all the consumer goods people want to buy, as well as all the investment projects borrowers have begun.

The unsustainability of such a monetary-induced investment boom has been shown, once again, to be true in the latest business cycle. Between 2003 and 2008, the Federal Reserve increased the money supply by at least 50 percent. Key interest rates, including the Federal Funds rate and the one-year Treasury yield, were either zero or negative for much of this time when adjusted for inflation. The rate on conventional mortgages, when inflation adjusted, was between two and four percent during this same period.

It is no wonder that there emerged the now infamous housing, investment, and consumer credit bubbles that have now burst. None of these would have been possible and sustainable for so long as they were if not for the Fed's flood of money creation and the resulting zero or negative lending rates when adjusted for inflation.

The monetary expansion and the artificially low interest rates generated wide imbalances between investment and housing borrowing on the one hand and low levels of real savings in the economy on the other. It was inevitable that the reality of scarcity would finally catch up with all these mismatches between market supplies and demands.

This was, of course, exacerbated by the Federal government's housing market creations, Fannie Mae and Freddie Mac. They opened their financial spigots through buying up or guaranteeing ever more home mortgages that were issued to a growing number of uncredit worthy borrowers. But the financial institutions that issued and then marketed those dubious mortgages were, themselves, only responding to the perverse incentives that had been created by the Federal Reserve and by Fannie Mae and Freddie Mac. Why not extend more and more loans to questionable homebuyers when the money to fund them was virtually interest-free thanks to the Federal Reserve? And why not package them together and pass them on to others, when Fannie Mae and Freddie Mac were subsidizing the risk on the basis of the "full faith and credit" of the United State government?

MORE MONETARY MISCHIEF IN THE POST-BUBBLE ERA

What has been the Federal Reserve's response in the face of the busted bubbles its own policies helped to create? Between September and December of 2008, the monetary base (currency in circulation and reserves in the banking system) exploded by 82 percent, from $905 billion to over $1.6 trillion. And over the last 12 months, from December 2008 to November 2009, the monetary base has continued to increase by an additional 18 percent to over $1.9 trillion.

At the same time, M-2 (currency in circulation plus demand and a variety of savings and time deposits) grew by 12 percent in calendar year 2008, and has continued to increase by 5 percent in 2009. Monetary aggregates like M-2 have not expanded even more in the last year due to the fact that about $1 trillion of the monetary base created by the Federal Reserve is sitting as excess reserves.

Why haven't banks lent out this huge amount of newly created money? Partly it is due to the fact that after the wild bubble years, many financial institutions have returned to the more traditional credit worthy benchmarks for extending loans to potential borrowers. This has slowed down the approval rate for new loans. (For trying to once again follow some of these more responsible lending practices, President Obama has been criticizing the banks for failing to once more expand loans to potentially overly risky business and investment ventures.)

But more importantly, those excess reserves are collecting interest from the Federal Reserve. With continuing market uncertainties about government policies concerning environmental regulations, national health care costs, the burden of the Federal debt and other government unfunded liabilities (Social Security and Medicare), as well as other possible political interferences in the marketplace, banks have found it more attractive to be paid interest by the Federal Reserve rather than to lend money to private borrowers. And considering how low Fed policies have pushed down key market lending rates, leaving those excess reserves idle with Ben Bernanke has seemed the more profitable way of using all that lending power.

Even under the heavy-handed intervention of the government, markets are fundamentally resilient institutions that have the capacity to bounce back unless that governmental hand really chokes the competitive and profit-making life out of capitalism. Any real recovery in the private sector will result in increased demands to borrow that would be satisfied by all of that Fed-created funny money currently sitting idle. Once those hundreds of billions of dollars of excess reserves come flooding into the market, price inflation will not be far behind.

But even before the private sector may wish to significantly increase their demand to borrow to undertake new investment, the funding of the trillion-dollar a year Federal deficits may end up using a good part of those excess reserves. Then those hundreds of billions of Fed-created dollars will enter the market to finance all of the government's spending that taxes are not paying for.

CENTRAL BANKING AS THE PROBLEM, NOT THE SOLUTION

At the heart of the problem is that fact that the Federal Reserve's manipulation of the money supply prevents interest rates from telling the truth: How much are people really choosing to save out of income, and therefore how much of the society's resources—land, labor, capital—are really available to support sustainable investment activities in the longer run? What is the real cost of borrowing, independent of Fed distortions of interest rates, so businessmen could make realistic and fair estimates about which investment projects might be truly profitable, without the unnecessary risk of being drawn into unsustainable bubble ventures?

Unfortunately, as long as there are central banks, we will be the victims of the monetary central planners who have the monopoly power to control the amount of money and credit in the economy; manipulate interest rates by expanding or contracting bank reserves used for lending purposes; threaten the rollercoaster of business cycle booms and busts; and undermine the soundness of the monetary system through debasement of the currency and price inflation.

Interest rates, like market prices in general, cannot tell the truth about real supply and demand conditions when governments and their central banks prevent them from doing their job. All that government produces from their interventions, regulations and manipulations is false signals and bad information. And all of us suffer from this abridgement of our right to freedom of speech to talk honestly to each other through the competitive communication of market prices and interest rates, without governments and central banks getting in the way.