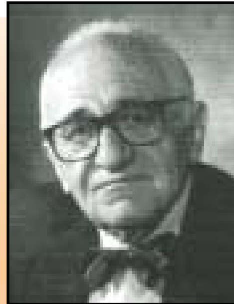
MURRAY NEWTON ROTHBARD

prof. Ing. Ján Lisý, PhD.



Murray N. Rothbard (1926 – 1995) was undoubtedly one of the most important followers of the economic teachings of L. Mises. He continued and further developed the theoretical and methodological legacy of Mises. He was a great adherent and supporter of Mises' praxeology. In his work in the tradition of the Austrian Economic School, he applied the principles of methodological individualism and methodological subjectivism, the subjective theory of limit utility and the deductive method as the basis of praxeology. Rothbard's contribution to the theory of money in a free society, central banking and the theory of the economic cycle can be especially emphasised. Strong criticism and rejection of state interventions and all forms of statism combined with a clear preference for private ownership, the inviolability of the freedom of citizens and the application of liberalism in all spheres of social and economic life are typical of him. His scientific works are not concerned only with economic problems. He also significantly contributed to the areas of ethics, philosophy, methodology and history. The scientific work of Murray Rothbard also significantly contributed to the fact that the theory of the Austrian School is still dynamically developing and constantly being updated with new approaches.

M. N. Rothbard was born in 1926. In 1942 he completed his secondary education in New York. In 1945 he gained the title of Bachelor of Mathematics at Columbia University, where he completed his university education in economics in 1946. He defended his doctoral thesis at Columbia University in 1956 and gained his PhD.

M. Rothbard significantly developed Mises' tradition of the Austrian School in the second half of the 20th century in the USA. Rothbard was one of the active participants in Mises' famous seminars at New York University from 1948 to 1969. He was a founder of the first periodical specially devoted to the economic teachings of the Austrian School – Review of Austrian Economics. During his academic career, he published 25 books and thousands devoted to criticism of state intervention, emphasising the freedom of the individual and explaining the advantages of the free functioning of the market. His first important extensive work was published in 1962 under the title „Man, Economy and State". Rothbard's second book, "Power and Market" published in 1970, presents his comprehensive theory on the functioning of the market system. In several works, he devoted attention to the problem of money and banking. The book "Money in the Hands of the State" (1962) analyses the origin and essence of money in a free society and points out the negative effects of state intervention in monetary circulation. In 1975, he published a book under the title "America's Great Depression". Rothbard's conception of the free market economy would not be complete without his work "The Ethics of Liberty", published in 1981. He explains in it the moral foundations of the free society, in which private ownership forms the essence. In his last two works, "Classical Economics" and the "Economic Thought before Adam Smith" from 1995, he analyses and describes the development of economic thought and endeavours for a renaissance of Scholastic economic thought. According to Rothbard, they understood the essence of the market system much more accurately than A. Smith.

The free market and the hegemonistic system

When explaining the basic principles of the free market economy, Rothbard theoretically and methodologically continues the academic legacy of Ludwig von Mises and further perfects and develops it. The basis is the application of the praxeological method, which is based on human activity and on logical deductions deriving from human behaviour. Praxeology assumes that the person is an active being and his activity is rational and deliberate. The aim of human activity is to achieve a better situation than the existing one. On the basis of praxeological analysis, Rothbard defines two basic socio-economic systems: the system in which market principles are applied and the system in which hegemonistic principles are used.[1] The application of market principles contributes to harmony in the system, and secures the freedom, prosperity and effectiveness of society. The implementation of hegemonistic principles causes conflicts, force, ineffectiveness, poverty and chaos. The real socio-economic system is a combination of these two basic principles: the market and the hegemonistic. The more market principles are applied in particular conditions, the freer and more effective the economy will be.

[1] For details see the publication: Rothbard, M.V.: Ekonomie státních zasahů (The Economics of State Intervention), Liberální institut, Prague, 2001

The more hegemonistic principles are applied and implemented, the greater the taxes and redistribution, which causes the growth of poverty, passivity of people and generaleconomic ineffectiveness. All gain in a free market, and the gain of each individual is the result of the fact that other people also gain. The free market maximises social utility, since all participants in the market derive benefit from their free activity. In the conditions of a free market, all who use their abilities to satisfy the needs of consumers, receive profits.

In conditions of forced exchange, when the state forces individual actors to exchange by means of state intervention, one group of people gains at the expense of another group of people. In conditions of state intervention and state redistribution, more is gained by the group of people, which can force the economically active people to give up to the state a larger part of their income. State tax policy and redistribution of the resources so gained, as well as the granting of various social and economic privileges for various persons and groups, disturbs the effective functioning of the market mechanism. For example, Rothbard shows that granting various forms of social aid to the poor increases poverty and unemployment, and motivates these groups in the population to have more children, which further deepens and sharpens the problem, which the government originally wanted to solve. Thus, social support for the poor actually increases their number, which further increases the amount paid in social support, which finally comes from the taxes paid by the economically active people.

Similarly, various forms of grants to companies prolong the life of ineffective firms at the expense of the effective and promising, which disturbs the rational structure of production and creates obstacles to the allocation of production factors from non-productive to productive branches. This leads to a significant violation of market principles, for which all consumers and businesses pay in the end.

Rothbard shows that "only the market enables the origin of a profound instrument of capitalist calculation, which is essential for the effective and productive allocation of production factors. Every form of state ownership or intervention in the functioning of the market disturbs the allocation of resources and creates islands of calculation chaos in the economy. State taxation and granting of monopoly privileges disturbs the market process of adaptation and leads to reduction of the standard of living. Inflation caused by the state not only harms one part of the population while advantaging another, it may also lead to the origin of an economic cycle, recession and collapse of the currency."[2]

The theory of money

In his analysis of the essence of money, Murray Rothbard consistently relies on the theory of his predecessor Ludwig von Mises. He starts from really occurring market and exchange processes, and explains that money has the essence of a commodity and originated as a result of voluntary co-operation between people. The state has no credit for the origin of money. In the process of development of the market economy in conditions of free competition, two commodities – gold and silver – became established as money and replaced other goods previously fulfilling the function of media of exchange. These two commodities had the best properties for fulfilling the function of money. The functioning of the free market confirmed that gold and silver are the most effective money as a result of their properties. Rothbard explained that such a freely occurring process of market competition, which generates the means of exchange, represents the only possible method for the origin of money. Money originated as a result of the free functioning of the competitive market exchange process. The state never had and still does not have the strength and ability to create money for the functioning of the economy. Rothbard claims that "it is best to leave the market to decide the size of the money supply, just as with other types of commodity. Apart from the communal, moral and economic advantages of freedom over coercion, no decreed size of money supply will function better than another size of supply, and the free market decides on the production of gold according to its relative ability to satisfy the demand from consumers in comparison with another productive use".

In his works on money, Rothbard[3] shows that free competition and the free functioning of the market has the ability to find out whether the gold standard with gold representing money, the silver standard with silver representing money or parallel standards with both metals representing money and the exchange rate between them freely floating, is the most effective. Free functioning of the market finally led to a situation in which one metal – gold – became money. On the basis of these findings, Rothbard came to the conclusion that it is necessary to return to full backing of paper money with gold. This would prevent inflation, since it would not be possible to issue paper money, which is not backed by gold. According to Rothbard, the free market and competition can exist without state intervention also in the area of monetary circulation.

Rothbard realised that the origin of money was an important impulse for the development of the market economy, but it also assisted the origin of a dangerous method by which the government could begin to expropriate the resources of individuals. In conditions of natural exchange, the ruler could expropriate resources only by confiscating goods in their natural form, but in a monetary economy, government officials can obtain part of the resources of the citizens by taxation. Therefore, the government endeavoured to gain control over the supply of money. The first measure was that governments introduced laws giving themselves the right to a monopoly on the striking of coins. The origin of the mint monopoly and the enactment of so-called legal tender represented the basic preconditions for the government fully controlling monetary circulation.

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[2] Ibid. p.400 – 401.

[3] Rothbard, M.N.: Peníze v rukou státu (Money in the Hands of the State), Liberální institut, Prague, 2001, p.43.

However, the existence of metallic money was a great obstacle to the occurrence of inflation. The control of monetary circulation and misuse of money could be complete only when governments began to use money substitutes – paper money and bank deposits – instead of metallic money. The gold standard and the standard of gold currency gradually disappeared, and the standard of not backed paper money was created.

Rothbard explains that when governments definitively excluded gold from the monetary standard and replaced it with money substitutes they could apply an inflation policy advantageous to the government without much difficulty. The government is only endangered by hyper-inflation. However, if hyper-inflation does not occur, the government, through the central bank, can regulate the supply of money and the rate of inflation. However, government intervention with the aim of solving some specific problem usually causes many other unexpected problems. In the conditions of a modern economy, when every country has its own paper money, the international division of labour based on an international currency is disturbed, and pressures for the abandonment of international co-operation and the formation of self-sufficient countries are created. Insecurity in currency relations does not contribute to the stable development of international trade, and this threatens the standard of living in individual countries.

Various exchange rates exist between the currencies of individual countries. The danger of an outflow of gold no longer threatens the country with a higher rate of inflation than others. However, other problems arise in the monetary area. The exchange rate in relation to the currencies of other countries declines, as a result of which the cost of imports increases, which has a negative impact on the development of the balance of trade.

Rothbard explains the reasons, which lead to the state following an inflationary policy. In his view, inflation is a very effective and cunning way for the government to obtain resources from the citizens. It is an apparently invisible and painless form of taxation, but for the development of the economy, it is also a very dangerous way of obtaining financial resources. Inflation generally causes a decline of economic well-being. The increasing quantity of money in circulation increases prices. This process of distribution of a greater quantity of money lasts for some time and occurs unevenly. Therefore, some people and groups gain, while others lose in different times and places. To put it simply, companies and shops, in which people spend their money sooner, increase their incomes before the prices of the goods they buy go up. On the other hand, "more distant" places in the economy contain entities, which have still not received the new inflationary money. They must bear the growth of prices before their income begins to increase. This means that in the inflationary process, the bodies, which receive money first, profit, while those, which receive the new money later, lose. It is clear that this process leads to a redistribution of wealth in favour of the first holders of the new money at the expense of those, which gain the new money later. Inflation means a race in which the most important thing is who receives the new money first. In these inflationary races, the people, who suffer most, are those with fixed incomes such as teachers and state employees, who always lag behind in their ability to obtain the new money. These people have wages agreed before the inflationary growth of prices. Inflation also afflicts people with life insurance, who have a firmly fixed levels of insurance payment, pensioners, who have concluded contracts about pension insurance, owners of property, who have concluded long-term tenancy agreements, owners of cash or obligations. A serious consequence of inflation is that it creates illusory profits and disturbs economic calculations. Rothbard shows that "by creating illusory profits and disturbing economic calculation, inflation removes the ability of the free market to punish ineffective companies, while rewarding effective businesses. All companies will apparently prosper. The general atmosphere of market selling causes a decline in the quality of goods and services for businesses, since consumers avoid increased prices less, when they take the form of worsened quality. In the course of inflation, people succumb to the appearance of rapid enrichment. Inflation punishes thrift and supports the creation of debts, because the amount of borrowed money will be paid with the help of money with a lower purchasing power in comparison with its original value. This discourages saving, while motivating people to borrow and pay later. Therefore, inflation reduces the general standard of living by creating a false feeling of prosperity.[4]

The causes of the cyclical development of economies

Rothbard describes and justifies the influence of inflation on the course of the economic cycle. On the initiative of the government, the banking system creates new money and puts it into circulation in the form of loans granted to businesses, for which these resources represent a form of real investment. Such raising of the supply of loans causes a decline of interest rates. This situation influences the activity and decision making of all actors in the credit market. Businessmen and investors take their decisions as if the interest rates were reduced as a result of increased savings. An impression arises that the amount of capital, which can be invested in the production of new products, has increased. The decline of interest rates leads to consumers reducing their savings, but entrepreneurs increase their demand for credit and continue to invest as a result of the low interest rates. From their inflationary credits, the companies finance higher wages for their employees and pay higher prices for investment goods. Production of investment goods increases and previously unused productive resources begin to be used. This leads to a situation in which the market does not have enough capital in relation to the growing production. The consumers do not increase their savings, because they increase their consumption, which

[4] Ibid. p.63.

increases demand for consumer goods. An economy existing in conditions of scarcity with a limited quantity of productive resources cannot produce a greater quantity of consumer goods and a greater quantity of investment goods at the same time. Rothbard shows that when new inflationary money gets into circulation, the wealth of the economy does not change, only its structure changes in conditions in which market principles are not applied. The granted credits are not the product of voluntary savings, as in the case of investment generated by a freely functioning market. Businessmen invest this new money obtained in the form of credits in various products, and pay for the purchased productive factors in the form of higher wages and prices. This new money gives the impression that savings increased, although this is not true in reality and so the investments turn out to be ineffective, uneconomic and unpromising.

As a result of the issuing of inflationary money, the economy gets into a situation, in which many productive resources are placed in branches, where they cannot be completed and used. Businessmen begin to perceive a shortage of money, interest rates rise, and pressure to limit business activity appears. Thus the artificially evoked expansion of the economy by issuing inflationary money and a policy of cheap money leads to a phase of recession, which begins the gradual process of removing the bad investments and returning to the effective allocation of productive resources. The process of allocating productive resources so that they will be placed in accordance with market principles and will be effective and promising, requires significant costs, since part of the expended resources cannot be recovered.

Analysis of the essence of money and the banking system enabled Rothbard to explain the causes of the origin of inflation as well as its influence on the cyclic development of the economy. According to Rothbard, inflation is always dangerous for an economy, since it causes economic imbalance, which leads to the enrichment of some actors in the market at the expense of others.

Rothbard was convinced that the market and the market mechanism can decide most effectively about the size of the money supply. Freedom can function effectively in the area of monetary circulation, just as in other spheres of the market economy. According to Rothbard, even monetary circulation does not require state intervention, since the government is an essentially inflationary institution. Rothbard thinks that the structure of the banking system, headed by the central bank and the operating commercial banks, is responsible for the origin of the economic cycle. In his view, central banking in a free market economy is an artificial and heterogeneous element, which causes all the serious economic problems.

Rothbard thinks that paper money, appearing in various forms, is also a means of unjustified enrichment in the international sphere. He showed that all the systems of paper money are products of the state, and the formation and effort to perfect the international monetary system is a continuation of the redistribution of wealth in the international framework. Therefore, Rothbard takes a critical view of the future development of international monetary problems. He states that "world paper money and a world central bank are the ultimate aim of world leaders inspired by Keynesianism, and the more immediate aim is a return to a form of the Bretton Woods system. Various central banks are already endeavouring to coordinate monetary and economic policy, harmonise inflation rates and set exchange rates. The militant pressure for the creation of a European paper currency issued by the European central bank is apparently bringing very early success. This aim is interpreted for the gullible public on the false pretext that the European economic community based on free trade requires an overall European bureaucracy, unified taxation in the whole territory and especially the creation of a European central bank and paper currency. When this aim is achieved, co-ordination with the Federal Reserve System will follow. Is the establishment of a world central bank unforeseeable?[5] Thus, according to Rothbard, the future of the dollar and the whole international monetary system is very uncertain.

Rothbard supposes that if we do not return to the classical gold standard with realistic prices of gold, the international monetary system is condemned to constant shifts from floating exchange rates to fixed exchange rates and back again. Both these systems bring insoluble problems, function badly and finally collapse. This prediction can be changed only by a fundamental change in the American and world monetary system, consisting of a return to commodity money in a free market, for example gold, and complete exclusion of the state from the monetary scene.[6]

[5] Rothbard, M.N.: Peníze v rukou státu (Money in the Hands of the State), Liberální institut, Prague, 2001, p.104.
[6] Ibid.

The most important economic works of M. N. Rothbard

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