ECONOMIC EDUCATION BULLETIN

AMERICAN INSTITUTE FOR ECONOMIC RESEARCH
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A.I.E.R. AFTER 50 YEARS

Our History and Plans for the Future

ECONOMIC EDUCATION BULLETIN

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INTRODUCTION

AMERICAN Institute for Economic Research, founded in 1933, is an independent scientific and educational organization. The Institute's research is planned to help individuals protect their personal interests and those of the Nation. The industrious and thrifty, those who pay most of the Nation's taxes, must be the principal guardians of American civilization. By publishing the results of scientific inquiry, carried on with diligence, independence, and integrity, American Institute for Economic Research hopes to help those citizens preserve the best of the Nation's heritage and choose wisely the policies that will determine the Nation's future.

The Institute represents no fund, concentration of wealth, or other special interests. Advertising is not accepted in its publications. Financial support for the Institute is provided primarily by the small annual fees from several thousand sustaining members, by receipts from sales of its publications, by gifts, and by the earnings of its wholly owned investment advisory organization, American Investment Services, Inc. Experience suggests that information and advice on economic subjects are more useful when they come from a source that is independent of special interests, either commercial or political.

The provisions of the charter and bylaws ensure that neither the Institute itself nor members of its staff may derive profit from organizations or businesses that happen to benefit from the results of Institute research. Institute financial accounts are available for public inspection during normal working hours of the Institute.

I. HISTORICAL PERSPECTIVE

A comprehensive history of the Institute since it began operations in 1933 is beyond the scope of this publication, but we believe that this historical summary will provide perspective for subsequent sections of this booklet.

Although serious intellectual work almost invariably requires the cooperation of others and draws from prior work by others, especially in its earlier years, the Institute's work was shaped predominantly by the research of its founder and later Director Emeritus, Col. Edward C. Harwood (1900-1980).

Col. Harwood, a graduate of the United States Military Academy, was serving in the Army Corps of Engineers in the 1920's when he undertook as an avocation the intensive study of economics, with particular emphasis on money-credit problems. In the beginning, he lacked both the advantages and the disadvantages of formal education in that field. He began by frequenting a library and reading books on economics by authors whose names began with "A." In less than 3 years, he had gone through that collection. Among the primary results of his program was awareness of: the prevalence of substantial conflicts among the views of professional economists; the obvious chaos in economic exposition; and the semantic swamp into which most authors were irretrievably mired as a result of pre-scientific notions as to how we know that we know anything.

Because what would qualify as scientifically warranted conclusions concerning economic problems were not to be found, Col. Harwood detoured, as it were, into an intensive study of what the philosophers and logicians had said about human knowing. Again it was evident that most such inquiries remained mired in a semantic swamp, although some American philosophers, beginning with Charles S. Peirce and William James, had broken with the ancient traditions and had begun to develop a promising mode of inquiry based on scientific procedures; an analysis that later was more fully developed by John Dewey and Arthur F. Bentley. From the beginning, then, and unlike most economic research organizations, the Institute has emphasized procedures of inquiry as applicable to problems in all fields, including economics.

In 1928 and 1929 Col. Harwood wrote several articles published in the financial journals of that period in which he warned that the speculative boom then underway was attributable primarily to the excessive creation of purchasing media (i.e., inflating the money supply) and that failure to stop the inflating process would lead to a major "bust" following the "boom."

By 1933 the magnitude and duration of the Great Depression suggested the need for an independent research organization that would inquire into the wide range of economic, social, and monetary developments that had contributed to the catastrophic "bust." The hope was that by further development and application of modern scientific procedures of inquiry, warranted assertions would be developed that would be useful to the Nation in avoiding a repetition of the disaster.

An obvious problem was how to avoid financial dependence on a few individuals with pet panaceas or on groups with special interests. Dr. Vannevar Bush, then vice-president of the Massachusetts Institute of Technology, suggested that some of the results of economic research might be helpful to individuals seeking to resolve their personal economic problems and that the sale of publications based on the research could provide a significant source of income. If, in addition, small annual contributions could be gained from thousands of individuals, an organization entirely independent of any one or a few wealthy individuals, or of a conventional endowment fund, might be possible.

With the sum of $200, the Institute began operations in 1933 under the direction of Col. Harwood. The initial basic plan proved sound. Institute publications enjoy a wide sale, and thousands of Sustaining Members provide a financial base for the work of the Institute. Initially AIER was housed in the office of a staff member at the Massachusetts Institute of Technology, but soon expansion required more space. Buildings in Cambridge, Massachusetts were used for several years. The move to the present property in the Berkshire Hills of western Massachusetts was made in 1946. By 1953 the Institute again was outgrowing its space and further expansion was required. In 1962 a research library having 10,000 square feet of space was completed. Housing for staff members, graduate students, and Fellows was completed in 1968.

Related Organizations

In addition to economic research, the Institute for many years also provided investment advice for individuals. After 25 years, the Internal Revenue Service changed its earlier ruling and terminated AIER's tax exemption on the ground that the investment advisory part of AIER's activities was in the nature of a taxable business. A prolonged legal battle followed, and in 1965 the Institute's tax exemption was restored retroactive to August 1, 1963. The investment advisory work was transferred to a new corporation as part of the settlement of that litigation.

In 1975 the Securities and Exchange Commission moved against the investment advisory firm; AIER; Progress Foundation of Switzerland; other European entities whose investment programs had been recommended by the advisory firm, or that had relationships with AIER; and several individuals employed by some of the organizations. After prolonged Court proceedings and a lengthy audit by a Court-appointed auditor, it was shown that no money had been embezzled and no records destroyed. The Court proceedings, insofar as they involved AIER, were terminated on April 17, 1979.

On February 5, 1979, American Investment Services, Inc. (AIS), wholly owned by AIER, was registered with the SEC as an investment advisor, and began operations. AIS applies AIER's fundamental research findings and procedures in developing its recommendations for individual investors, shares AIER's facilities, and is the only investment advisory organization that is recommended by AIER.

Although the primary emphasis of AIER is on economic problems, those problems do not occur in a vacuum. Moreover, the semantic swamp in which most conventional economists are bogged down also traps conventional inquirers in the other social and behavioral science fields. In the early 1960's with the aid of AIER and stimulated by Col. Harwood, the Behavioral Research Council for Scientific Inquiry into the Problems of Men in Society (BRC) was founded. Two of the books published by BRC, *A Current Appraisal of the Behavioral Sciences* and *Useful Procedures of Inquiry*, have been unusually successful. In 1968, again with the aid of AIER and stimulated by Col. Harwood, Progress Foundation was founded in Switzerland for research on the advance and retardation of civilizations.

AIER's long-standing reputation for integrity, in part reflecting its independence from special-interest groups, has enabled it to weather many crises. Each time AIER has emerged in even stronger condition. Its emphasis not only on proposed solutions to fundamental economic problems but also on modern procedures of inquiry into those problems in their full socio-cultural context, makes AIER unique among economic research organizations. AIER's longer-run success will be aided greatly by a program of charitable giving established in late 1969 whereby donors transfer property to AIER but reserve a life income interest for themselves and other beneficiaries. In late 1983, the market value of the assets held in these trusts was approximately $100 million. As AIER receives the principal through the years, our scientific and educational work can be expanded.

II. THE ORGANIZATIONAL STRUCTURE

IN the search for a form of organization that would ensure the independence of AIER from the influence of concentrated wealth or special interests, that would maintain its tax-exempt status, and that would ensure continuing research of high quality, various forms of organization were tried from which the present mode evolved. In accord with the Institute Bylaws, three echelons of authority exist: the Voting Members (now more than 80), the Board of Trustees (a maximum of 13), and management.

The purposes of the Institute are: "to conduct scientific research in the general economic field and to disseminate the results of such research in order to educate individual students and the general public, so that there may be more widespread understanding of the fundamental economic relationships affecting the citizens of the United States, both as individuals and as members of a complex society, with the ultimate objective of advancing the welfare of the American people."

To achieve those purposes, maintain the independence and freedom of inquiry of the professional staff, and assure that the public interest is protected, the following provisions are included in the Bylaws:

Part I. 1. In order to avoid any possibility of bias resulting either from an attempt to satisfy wealthy donors or to protect substantial invested funds, the Institute shall seek to derive its support primarily from many small contributions by the general public and the distribution of publications and reports presenting the results of the scientific research undertaken. No attempt shall be made to seek an endowment fund from wealthy interests.

2. All funds received shall be devoted to scientific research and educational purposes through the dissemination of the results of such research within a reasonable time after the receipt of such funds, and the accumulation of a surplus (over any required reserves) in excess of the aggregate expenditures of the Institute for the year preceding is prohibited. Any funds that from time to time become available in excess of that amount shall be devoted forthwith to scientific research or to the dissemination of educational information or such related charitable activities (including both undergraduate scholarships and graduate fellowships) as are consistent with the purposes of the Institute.

3. The Institute shall be absolutely nonpolitical; no Institute funds shall be contributed to any political party, nor shall any of the Institute's personnel be permitted to carry on political activities of any kind during the regular hours of duty. Such political activities shall constitute ground for immediate removal for cause by the President.

4. No attempt shall be made to propagandize, nor shall any effort be made to influence legislation, either Municipal, State or Federal.

5. There shall be no shareholders or individuals having a personal or pri-

vate interest in the resources of American Institute for Economic Research, nor shall the Institute's resources be appropriated for the purpose of providing any monetary profit or other private or selfish advantage for any individuals.

6. The Institute may not accept gifts of money or any other property that carry with them or involve any restrictions on the scientific procedures of research to which such funds are to be devoted, or the period within which they are to be used, or that would involve activities other than those contemplated herein.

7. None of the income or property of the Institute may be divided among or distributed to any individuals, except the reimbursement for services rendered as herein specified; nor may any funds be appropriated and expended for any other than the scientific, educational, and charitable purposes of the Institute. This bylaw shall not be amended.

8. The names of the individuals who contribute to the Institute, become Annual Sustaining Members, purchase its publications, or inquire regarding the Institute's activities, shall not be rented or sold to any other agency or individual.

Part II. 16. The books of American Institute for Economic Research shall be open to the public at all times during the hours when banks in Massachusetts are required to be open for business.

Part IV. 3. All persons employed for research or other activities on the Institute's staff shall make known to the Director of Research and Education any connection with commercial or other outside interests.

Part V. 4. The Institute shall continue its policy as stated in these bylaws of conducting inquiry in all aspects of economics and disseminating the results of such inquiry to as many as possible of the general public to whom such results of inquiry may be useful. The Institute represents to the public that its inquiries, reports, and conclusions are not inhibited by the pressures of vested interests. Therefore, within the limits of its capacity for scientific inquiry and publication, the Institute shall inform the public promptly and fully and shall not suppress or inhibit publication of the results of inquiry; and the Institute shall answer inquiries about its findings and conclusions to the full extent readily practicable.

5. Neither the Faculty nor the Trustees of American Institute for Economic Research shall have authority to suppress or inhibit publication of the results of inquiry nor shall they inhibit or prevent the appropriate answering of questions received when the answers to such questions are available. This policy requires on the part of all Members of the Corporation, Trustees, and Faculty no interference whatsoever with the academic freedom of all professional employees to apply the code of a behavioral scientist formulated by the Behavioral Research Council as follows hereafter; and it requires that every professional employee of the Institute as a condition of employment

state in writing his intention to adhere to that code without mental reservation or purpose of evasion:

"My primary and overriding moral commitment or obligation is to serve as a behavioral scientist for the purpose of seeking solutions for the problems of men in society and publicly informing my fellow citizens as to the results of such scientific research. This implies:

a. Relying in such inquiries on the methods of modern sciences in their evolutionary development,

b. Endeavoring continually to improve my own ability as a scientist to develop warranted 'if-then' conclusions or assertions by applying scientific methods and by subordinating any personal biases in order to assure objectivity in my work and findings,

c. Avoiding all conflicts of interest (such as might result from employment by special interests, etc.) that might inhibit scientific work or bias me in any way tending to pervert scientific inquiry,

d. Differentiating clearly in all writings and public statements so that those to whom I communicate will understand whether I am speaking or writing in my role as scientist within my field of competence or am simply urging in my role as a citizen or in some other specified role a course of action that I personally prefer,

e. Criticizing as unscientific, without fear or favor, all purportedly scientific reports within my field of competence that (in the absence of such criticism) could be expected seriously to mislead my fellow citizens, whom I have chosen to serve."

6. The results of the Institute's scientific research, as embodied in all reports published by the Institute, shall be available to the general public as well as to all educational institutions; and no recipient of any Institute publications shall be required to keep such material confidential. All such material shall be freely available to students and research organizations in the field and may be quoted in full or in part with or without credit by such individuals and organizations.

III. AIER PROCEDURES OF INQUIRY

As noted in the historical introduction, AIER places strong emphasis on procedures of inquiry. Many individuals, perhaps particularly those who have had many years of formal education, have some reason to believe that they know a great deal. Nevertheless, few even among those who are teaching such students are able to describe coherently and consistently how anyone knows that he knows anything. Therefore, we begin with the question: How do you know that you know anything?

Your first reply may be that you have devoted many years to acquiring knowledge, that you have demonstrated to the satisfaction of many teachers that you have acquired knowledge, and that there is no doubt in your mind that you know what you know. In short, you are convinced that your own confidence in the knowledge you have acquired is a sufficient guarantee that you know what you know.

If such is your answer, we then suggest that it raises at least two more questions. The first is: What is knowledge?

Philosophers have been busy for at least 2000 years in an attempt to answer this question. Those in one branch of philosophy, epistemology (the science of knowledge), have given this problem their primary attention for many centuries. Unfortunately, they have not yet been able to agree on an answer; and few even agree on the usage of words in which they endeavor to state the answer. Dewey and Bentley offer this comment:

> "*Knowledge*: In current employment this word is too wide and vague to be a *name* of anything in particular. The butterfly 'knows' how to mate, presumably without learning; the dog 'knows' its master through learning; man 'knows' physics and 'knows' mathematics; he knows *that*, *what*, and *how*. It should require only a moderate acquaintance with philosophical literature to observe that the vagueness and ambiguity of the word 'knowledge' accounts for a large number of the traditional 'problems' called *the problem of knowledge*. The issues that must be faced before firm use is gained are: Does the word 'knowledge' indicate something the organism possesses or produces? Or does it indicate something the organism confronts or with which it comes into contact? Can either of these viewpoints be coherently maintained? If not, what change in preliminary description must be sought?"*

For the purposes of discussion we accept this quoted comment at face value and note that how one knows what he knows is a more complicated matter than it first appears. If firm, consistent, and coherent use of the name "knowledge" has not been achieved by the eminent philosophers who have

* John Dewey and Arthur F. Bentley, *Knowing and the Known*, Boston, Beacon Press, 1949, p. 296. Reprinted in entirety in Rollo Handy and E. C. Harwood, *Useful Procedures of Inquiry*, Great Barrington, Behavioral Research Council, 1973, in which the quotation appears on p. 176.

devoted their lives to studying epistemology, perhaps we are justified in avoiding the further use of the word.

We turn now to a second question raised by your supposed answer to our basic question: To what extent is your confidence that you know something a sufficient guarantee that you know what you think you know?

Many people who demonstrably do not know what they are talking about are supremely confident that they know what they know. Every hospital for psychopathic disorders has such patients; and who does not have acquaintances, not as yet incarcerated, who are similarly confident that they know what others believe no one can know? Consider also the knowing behavior characteristic of primitive peoples and even of people in an advanced stage of civilization whose knowing reflects views, religious views perhaps, at variance with your own. You probably believe that they obviously do not know what they are so confident they do know. Our own forefathers knew that some people were witches – knew this well enough to hang or burn the supposed offenders. Yet we today assert that our forefathers, in spite of their great confidence, did not know what they thought they knew.

Sometimes such overconfidence is found even in developed scientific areas. For example, when Marconi proposed radio transmission between the United States and Great Britain, he was severely criticized by Heinrich Hertz. In a letter to Marconi, Hertz pointed out that the earth is round, that radio waves travel in straight lines, and that therefore the waves could not go across the Atlantic, but instead would go out into space, unless they were reflected back by "a mirror the size of a continent." Hertz, of course, was unaware of the so-called "Heaviside layer" (ionosphere) that serves as a reflector, so his apparently unanswerable refutation of Marconi's proposal turned out to be wrong.† What at one time seems to be a convincing proof frequently is revealed at a later time to be erroneous.

These considerations suggest that simply having a superabundance of confidence in what one knows is not a sufficient guarantee that what he "knows" is the way things are.

Scientists' Procedures of Inquiry

Evidently, in order to answer the basic question, How do you know that you know anything?, we shall have to inquire into the matter more adequately than have innumerable philosophers in the past. What we seek are procedures that yield descriptions useful for resolving problems. Useful descriptions yield reliable predictions of what probably will happen, and thereby facilitate control of future events and/or adjustive behavior to those

† This example comes from Colin Cherry, "Language and Extra-Linguistic Communication," in Noel Minnis, ed., *Linguistics at Large*, New York, Viking Press, 1971. Cherry notes also that the flat-earthists were delighted by Marconi's success, which they took as proof that the earth is flat.

events. Presumably, the best procedures of inquiry thus far developed are those used by inquirers who have demonstrated their ability to succeed most consistently in resolving problem situations.

By the middle of the 20th century the inquiries of men into problem situations had achieved enough success to encourage hope for rapid progress. The new developments are perhaps the most important "breakthrough" in the long history of man's evolutionary progression. When the significant features are generally understood and applied, inquirers into the problems of men in society may become as successful in developing warranted assertions as the physical scientists and the physiological scientists have been in recent centuries.

A highly important aspect of the new developments in inquiry is reorientation to a different goal. From the beginning of man's inquiries into problem situations, typically the accepted objective was *Truth* or absolute certainty. By the time written records were kept, that goal generally was unquestioned. Moreover, the quest for certainty was the accepted goal even of the relatively modern scientists during recent centuries.

If an inquirer into problem situations is to discard the "quest for certainty," what is he to substitute for that objective? Progress in inquiry perhaps is imaginable without a goal in view, but in the absence of an objective, how would one know whether or not progress had been achieved, and how would one know when a particular research task had been completed?

A suggestion is that the objective or goal of scientific inquiry is a description of what happens under specified circumstances. Ascertaining what happens is part of the scientific inquirer's job, but his task is not completed until he has provided a *scientifically useful* description of his findings. "Scientifically useful" as here applied is a name (short-hand designation) for a description that can be used by others as well as the initial inquirer for rechecking the inquiry, or as a basis for further inquiry, or as a means of modifying either external events or internal adjustive behavior, or for any combination of such purposes.

The objective of scientific inquiry here suggested does not include achievement of "knowledge" in any absolute or final form, does not purport to establish "certainty," and does not offer its findings as unalterable, indestructible *Truth* (whatever that may be). The goal of scientific inquiry is assertions warranted by the procedures of inquiry but not alleged to be fixed or immutable. The reports of scientific inquiry invariably are provisional, always being subject to revision if and when better means of observation and measurement or other improvements in procedures of inquiry make possible more useful descriptions of what happens under specified circumstances.

An important characteristic of the suggested procedures of inquiry is that they are self-corrective; that is, included among them are procedures for correcting earlier procedures. Humans have used various methods of inquiry, including those of common sense, revealed religion, secular revelations, seeking the aid of spooks and fairies, consulting the oracles, and Aristotelian logic, to name a few. By such means men have claimed to find certainty. Totally confident of their certainty, they have earnestly offered verbiage to embalm their findings in an indestructible, forever-established form, never to be doubted and, therefore, never to require amendment, updating, or reconsideration.

Some have been so sure that the methods of inquiry satisfactory to them had yielded absolute certainty that they have tied doubters to stakes and burned them. Although these are glaring examples, they may well have been among the less harmful actions – all things considered – that human beings have taken while laboring under the delusion that the methods of inquiry satisfactory to them have yielded ultimate truth.

The procedures of inquiry adopted by AIER are radically different and apparently are the only ones that provide for continuing development and revision of *both* the methods *and* the findings of inquiry.

Summary Description of Procedures Found Useful

A summary description of the procedures of scientific inquiry that we have found useful may be helpful to readers.

1. The objective of scientific inquiry is to provide useful descriptions of what happens under specified circumstances.

2. The adjective "useful" designates those descriptions that are adequate for such purposes as confirmation or refutation of the conclusions by duplicating the procedures insofar as may be practicable, or those descriptions of what happens that can be used to predict what probably will happen, or those descriptions of what happens that facilitate modification of future developments either by changes effected external to the human beings involved or by adjustive behavior on their part, or by various combinations of these.

3. An inquirer proceeds toward his goal of achieving useful description in a series of steps that may be described as follows:

a. First is awareness of a problem situation, of happenings for which a useful description is not available or somehow is inadequate.

b. Next is the attempt to ascertain the facts in the situation. However, the facts in the situation, including the relationships among various facts, usually are not readily apparent at first.

c. Difficulties arise; the development of adequate description of what is happening or has happened is blocked in one way or another, perhaps by the lack of sufficiently delicate instruments with which to observe and measure, perhaps by ignorance about some facts or aspects of facts pertinent to the investigation, or for any number of reasons.

d. Although temporarily blocked in the further development of adequate description, the inquirer does not abandon his inquiry. He develops notions or conjectures about the possible facts or relationships among facts that may be involved. Usually many different conjectures can be developed, and the inquirer's immediate problem then is selecting among them in order that inquiry may proceed. Aspects of the various conjectures suggest or point toward facts possibly not previously recognized as pertinent or in any event not yet adequately investigated. The inquirer proceeds to test one conjecture after another by returning to the facts in the case, perhaps discarding some facts at first thought pertinent, perhaps ascertaining new facts by experimental procedures or by further investigation in other ways. Eventually, adequately developed description is achieved so that the inquirer proceeds to the next point in his inquiry where his progress is blocked.

e. Again the inquirer imagines what may have happened and formulates (possibly with the help of mathematics) new conjectures, until a return to the again possibly revised facts or newly ascertained facts is possible in order once more to select the apparently most useful among alternative conjectures in order to proceed with the inquiry.

f. Ultimately, if the inquirer is successful, useful description of what happens (or what happened) under specified circumstances is achieved.

IV. FUNDAMENTAL ECONOMIC FINDINGS

ECONOMICS as a scientific field of inquiry does not involve a "philosophy" of the economic order, such as "Marxism," "socialism," "fascism," or "capitalism." As scientists, economists have the humble task of ascertaining and describing economic relationships. However, economic events do not occur in isolation from other social events. On the contrary, economic relationships are an integral aspect of social relationships, and the boundaries of strictly economic events within all social transactions frequently are not clear. Manifestations of these hazy boundaries are assertions involving moral judgments that lack scientific support. Defenses of the economic "philosophies" named above often contain such implicit or explicit moral judgments.

What can one use to assess which aspects of social arrangements constitute economic "progress" and which constitute "regress"? Our answer is to look at what human beings have striven for during the centuries of recorded history. One important objective they have striven for is freedom – freedom from the oppression of others, freedom from material want, freedom to develop as they choose, freedom to do the things they want to do.

Throughout history, a number of social arrangements have been tried. These arrangements invariably included a method for determining the allocation of available resources and of consumable things among the members of the social group. Some arrangements provided for control by a few based on brute physical strength (any number of tyranical or warlord societies); or on title by birth (monarchies and societies with rigid classes of people); or on mystical abilities (witch doctors and seers) and so forth. Records are available revealing the extent to which these varieties of social orders facilitated the achievement of freedom from oppression and want by the members of the social group. Thus judged, those arrangements hardly were successful.

About 8 centuries ago, a new, revolutionary social order began to evolve based on individual sovereignty. As agreements and decisions set forth and reaffirmed the rights of persons to be secure in their persons and possessions, the Common Law was established in England. Magna Charta was one landmark in the evolution of the new order; termination of Star Chamber proceedings was another.

However, the most significant of all events connected with the experiment of a social order based on individual sovereignty probably was the Constitution of the United States with its Bill of Rights. The U.S. Constitution reflects the basic Common Law rights of each person to liberty, to freedom from coercion by others, and to justice in that no one has a right to take without compensation the fruits of another's effort.

This social order based on liberty, freedom, and justice for each individual enabled human beings to achieve hitherto undreamed-of advances in obtaining the things humans wanted – material objects and other things. Two centuries ago, the United States was an infant nation, an economic pygmy in a world dominated by a few economic giants. In only 150 years, this pygmy rose to the stature of the greatest economic giant of all time.

To what aspects of the social order was such great progress attributable? Many have attributed it to the abundant natural resources of the Nation, and these no doubt helped. Yet, other nations have had the equal of U.S. natural resources but never flourished. Argentina, Brazil, and Russia are examples. Therefore, natural resources seem not to account for the swift progress. Rather, the key distinguishing aspect, as far as we have been able to ascertain, was a closer approach to liberty, freedom, and justice than ever before achieved. These conditions seem to foster the optimum development of each individual and of the social group by encouraging each individual to do more for himself by doing more for others.

Liberty, freedom, and justice evidently promote rapid economic progress in a number of ways. One way is by opening more activities to any person who cares to undertake them. The advantage of this is that persons who might be prohibited from developing and using their talents in specified fields in more restrictive social orders, in the new social order can turn their efforts to any task for which they might be best suited by interest or skill. Knowing in advance who might be a Thomas Edison or Henry Ford has not proven possible; therefore, the more who have the opportunity to develop their full talents, the greater the chance that specially gifted persons will be able to use their talents for the benefit of themselves and the social group.

A second way that liberty, freedom, and justice foster rapid progress is by offering the incentive of greater reward to those who better serve their fellows by producing and making available more of the things that their fellow human beings indicate they want. Although some human beings evidently do not need the incentive of a greater reward to exert themselves to the optimum of their capabilities, much evidence indicates that others do react to such incentives. Therefore, society can gain the benefit of their increased output by rewarding persons according to their part in providing the benefit.

Provision of higher reward to the more productive promotes progress in another way. Larger rewards take the form of larger claims on the resources and products of the society. Thus, in giving larger rewards to those individuals who by their actions demonstrate an ability to serve better their fellow humans, society gives the successful more control of the limited resources available to society. Oppositely, those who fail to make available useful things lose their power to claim and "waste" resources continually. By this procedure, society automatically and continuously reallocates control of its limited resources away from the less successful and toward the more successful. The inefficiencies possible in the absence of this mechanism for economic reward and punishment are evidenced by any number of government-funded operations, which in spite of general recognition of their hopeless inefficiency not only continue in operation but also make a claim on even more resources in order to overcome the inefficiency. Such is possible by the force of law that government wields. Wherever government has interfered with appropriate rewards, wasteful inefficiency has been much in evidence.

Some Arrangements that Apparently Aid Progress

Key aspects of a social order founded on liberty, freedom, and justice are the economic aspects grouped under the name, "free-enterprise competitive market capitalism." "Free-enterprise" simply is recognition of the right of individuals to associate voluntarily in groups to process things. "Markets" reflect the striking of bargains between those wanting to exchange. (A "seller" exchanges a particular thing for a claim to things in general, or money; the "buyer" exchanges the opposite.) "Competition" is another name for voluntary cooperation, as would-be sellers voluntarily strive to cooperate most effectively with would-be buyers and thereby earn the favor of an exchange. In doing so, would-be sellers voluntarily are guided into the economic roles where each can serve his fellows more effectively and thereby maximize his own reward. Capital is man-made wealth used to process other things; therefore, "capitalism" is the recognition of the private property rights of individuals applied to a particular type of man-made wealth, namely, that used for processing other things.

A social order reflecting a commitment to liberty, freedom, and justice implies a limited role for government, inasmuch as history records that more people have been oppressed through the mechanism of government than through any other device. This is not to say that government has no legitimate role; quite the contrary. Our Constitution set forth clear tasks for government, which can be summarized as the protection of liberty, freedom, and justice from those – domestic or foreign – who would deny them. Thus, defense of the Nation's borders from would-be conquerors is a proper province of government. The institution and administration of a legal system clearly is another legitimate task of government, but the system of laws and the administration of them must have as their objective the advancement of liberty, freedom, and justice if progress is to be optimized. In summary, the system should work toward providing and protecting a "fair field with no favor" in which each individual's freedom is restricted only as necessary to protect the equal freedom of others. This would appear to be a useful gauge by which to assess the probability that specific laws will foster progress or regress of the social order.

In practice, accurate assessment of the results of particular laws is not always possible. Consequently, even with the best knowledge and intentions, laws might be passed from time to time that lead to regress rather than progress. Therefore, it would be useful if laws were considered tentative, were reviewed continually for effect on the social order, and were changed readily when there is substantial doubt that they foster progress. The experimental aspect of society seems to be enhanced by a pluralistic order rather than monolithic order. That is, inasmuch as few aspects of social arrangements indisputably promote progress, most social arrangements in a sense are experimental, and the more pluralistic the society, the greater the opportunity to test the results of various social arrangements without the risk of committing the majority of society to the experiment. For example, a national educational system would subject more students to the risk of possibly counterproductive new educational methods than would a system of local educational programs. As the proliferation of Federal laws during recent years amply demonstrates, major harm to society is risked whenever power is centralized and the whole of society is used to test some largely untried "theory."

Imperfections and the Counterrevolution

In spite of the vast strides toward liberty, freedom, and justice and of the economic progress it fostered during the first 150 years of the United States, freedom by no means was complete and justice clearly was not achieved. Competition ensuring voluntary cooperation among market participants hardly was universal at the turn of the century. Women and children often worked 12 and 14 hour days in sweat shops. Urban slums were a common blight, and ostentatious wealth contrasted starkly with deep poverty.

In the haste to eliminate glaring social inequities and problems, many persons of good will failed to analyze the underlying reasons for the inequities they deplored. They did not ask whether the cause might lie in the direction of unrealized freedom and justice. For example, while the social arrangements of the time amply encouraged the efforts of the Henry Fords and Thomas Edisons to increase man-made wealth, they also enabled the likes of the Astor family to amass huge wealth not by processing things wanted by their fellow human beings but by purchasing much of the land in New York City and claiming as theirs the profit on that land arising from the value added to the site location by society's investment in the community around the sites. The injustice of an order allowing individuals to appropriate for their private use the natural resource wealth of the community was described vividly by Henry George in *Progress and Poverty*, first published in 1880. But this terribly harmful special privilege was not eliminated by appropriate taxing laws then, and it remains among the greatest injustices of the U.S. social order to this day.

Instead of seeking to wipe out the all-too-apparent inequities by exploring ways to increase liberty and justice, many disillusioned but well-intentioned persons abandoned the battle for freedom and turned to authoritarian (government) solutions to them. Others of ill will, seeking to enrich themselves by accumulating power and special privilege, were quick to support the demands

of the honest but misguided concerned persons. The counterrevolution away from freedom and human progress thus was born, and it has grown to this day. Marxism, socialism, fascism, the New Deal, the Great Society, and the Welfare State are all part of the counterrevolution. All involve the use of force (in the form of laws) to subjugate some persons to other persons, to benefit some at the expense of others.

In the United States the distresses of the 1930's stengthened the counterrevolution. Government program after Government program was passed ostensibly to reduce the suffering of the depression and to prevent a recurrence of it. The undreamed-of advance in economic well-being produced under conditions of relative freedom during the 6 or 7 decades prior to the Great Depression was quickly forgotten during the first few years of the depression. Instead of recognizing the depression as the inevitable result of excesses during the boom period of the late 1920's, economic "experts" alleged that there were fundamental defects in the free-enterprise capitalist system, defects requiring Government intervention for the restoration and future preservation of prosperity. John Maynard Keynes of England provided the theoretical justification for Federal deficit spending policies designed to maintain a high level of aggregate demand and, in turn, output and employment. President Franklin Roosevelt adopted Keynes' spend-for-prosperity nostrum in 1934. Since then, Federal deficit has piled on top of Federal deficit, year after year; yet, there is no evidence that long-run economic advance has been stimulated. On the contrary, the evidence of the 1970's strongly indicates that Government meddling with free-enterprise, especially in the form of inflationary policies, fosters economic inefficiency.

There now is increased awareness of the Nation's economic plight, but economists of today cannot agree on a set of policies that would end inflating, maintain economic expansion, and promote a high rate of economic growth. To us, it should not be surprising that all of these highly desirable objectives seem beyond reach. Why should anyone expect that a complex and relatively free social structure like that of the United States economy would function without dislocations developing from time to time? Literally billions of transactions occur daily among millions of persons, each reflecting personal preferences, an accumulated capital structure and productive machinery, a particular level of technology and of labor skills, a massive distribution network, and so forth. In addition, most of these things are changing daily, thus requiring information feedback to producers, savers, investors, consumers, etc. to help them adjust their behavior.

In short, some – but not necessarily extreme – fluctuations in business activity appear to be an inevitable part of a dynamic, free-enterprise capitalistic economy. The corrective contractions perhaps are no more avoidable than are the mistakes children (and adults) must make if they are to develop sound judgment and responsibility. If parents so protect their children that they have no freedom to make mistakes, the children are not likely to develop into healthy adults, able to partake of the fullness of life. Likewise, a strictly regulated economic order might reduce economic contractions but only at the unacceptable cost of denying its citizens the opportunity to do as they choose. Evidence shows that economic freedom not only is consistent with nobility of human life but also is conducive to a high rate of advance in economic well-being. Efforts to rid the economy of temporary adversities have had the unintended effect of preventing early corrections of distortions, of inhibiting the full development of economic capability, and of denying humans their sovereignty.

Early Evidence of the Accuracy of AIER Descriptions

As we mentioned above, the 1930's was a watershed period in that the counterrevolution gained marked momentum in part because economists misinterpreted the cause of the depression. Althouth the Institute did not begin operations until late 1933, the founder of the Institute, Edward C. Harwood, had begun writing on economic topics a decade earlier. Early in his studies, he turned his attention to monetary matters, particularly on the relationship between money available for purchasing things and things available to be purchased. This special focus on monetary economics has been maintained by the Institute throughout its history because money is of utmost importance in a complex economy. It is the oil of the economic machinery. When it performs well, it is hardly noticeable, but when it performs poorly, all parts of the economy function with wasteful stress. Every contract, every accounting record, and every transaction denominated in the monetary unit is falsified when a nation's currency is debased. Recent history unmistakenly attests to the pervasive problems associated with a failing monetary unit.

By the late 1920's, Col. Harwood had developed a procedure for estimating the amount of purchasing media in use in relation to that needed. When excess purchasing media were created, he concluded that inflating had occurred. Reference to earlier events convinced him that inflating was a proximate cause of business "booms" that inevitably were followed by corrective "busts."

On the basis of banking data, in 1929 Col. Harwood concluded that inflating was occurring at a rapid rate in spite of comparative stability of the popular price indexes. The excesses of inflating were concentrated in limited areas of the economy, notably the stock market and real estate. But the paper profits from these investments fostered spending on consumer goods that led to robust business activity in general. Col. Harwood predicted that the excesses of inflating eventually would lead to a recession.

The recession indeed did follow, but it persisted longer than usual. No doubt one reason for its prolongation was its worldwide scope, when foreign demand for export goods contracted along with domestic demand. In fact,

leaders of most nations worsened the business contraction by erecting legal barriers to international trade in the mistaken belief that doing so would aid their domestic economies.

Because prices fell and credit collapsed during the depression, careless analysts claimed that these were the cause of depressed economic conditions, rather than a symptom of it. The credit collapse was blamed on adherence to the "real bills" doctrine of the banking system, a practice that restricted bank creation of purchasing media to that associated with goods being offered in the Nation's markets. This practice was abandoned then and now is remembered by few. In its place, monetary authorities became free to promote the creation of whatever amount of purchasing media they considered appropriate in spite of not having a useful alternative guide to what amount would be appropriate.

Ostensibly to overcome the perceived problem of low prices, President Roosevelt devalued the dollar in 1934 by raising its "price" from $20.67 per ounce to $35 per ounce. At the same time, he confiscated, at the old rate, all gold held by Americans, thereby claiming for Government the "profit" on the rise in the price of gold. The devaluation of the dollar was a breach of integrity. In effect the Government said to all holders of dollar claims that they would get only 60 percent of the gold value for which they had contracted. By making gold illegal for Americans to hold, President Roosevelt denied them the opportunity to exchange their paper currency for the monetary metal demonstrated to be most useful over thousands of years of experience. These actions hardly could restore the confidence required for the private sector to lead the way out of the depression. After all, use of gold as the monetary unit had become the practice of all advanced nations during the period of rapid worldwide expansion of the late 1800's.

Such denials of freedom and disregard for a monetary unit of integrity do not make a firm foundation upon which lasting prosperity can be built. Add to these mistaken policies, the introduction of a Social Security system purposely designed to be underfunded by its participants, the establishment of regulatory agencies over many aspects of the economy, and the implementation of unemployment programs having the effect of paying persons not to accept jobs, and the Nation in just a few years was well down the counterrevolutionary road.

In the mid-1930's, the Institute could confidently predict that the adoption of spend-for-prosperity policies, together with the abandonment of domestic redeemability of the currency and of sound commercial banking, would foster a new wave of inflating and its attending excesses. World War II brought inflationary policies, but the public hoarded the excess purchasing media created. As a result, a massive reservoir of purchasing media was available at the end of the war, when many analysts were predicting a depression like that following World War I. However, the Institute's Index of Inflating (which evolved from Col. Harwood's earlier work on estimating excess purchasing media from banking data) suggested that a business boom, not a depression, would follow the end of the war. It did.

Nevertheless, the inflationary spend-for-prosperity policies of the Government continued, as did the occurrence of business cycles. During the late 1940's, the Institute undertook a study to find a useful procedure for forecasting business-cycle peaks and troughs. The procedure that was developed relied substantially upon the work of the National Bureau of Economic Research but also upon some original work of the Institute. Since then the procedure has been further developed by the Institute. Based on the record of our predictive accuracy, today we have the most useful method for forecasting business-cycle turns of which we are aware.

More Evidence

Throughout the 1950's and 1960's, the Index of Inflating warned of accumulating excesses. These were reflected in part in a chronic balance of payments deficit and in a substantial outflow of the Nation's stock of gold. By then the majority of the Nation's economists were dedicated Keynesians and committed opponents of a monetary role for gold. To them gold was an anachronism of by-gone days and the outflow of gold had no monetary significance. But to us, the outflow of gold clearly revealed that U.S. goods and financial assets were losing their competitive edge. Why else would foreigners prefer to use their dollar claims to take the gold rather than available merchandise or financial assets? We predicted more trouble ahead unless deficit spending and inflationary policies were abandoned.

Instead of less centralized control over the economy, the Nation was afflicted with Lyndon Johnson's Great Society program. Billions were spent on income redistribution programs, Medicare and Medicaid were introduced, urban renewal efforts amounted to further billions, and at the same time the Vietnam War effort involved tens of billions of dollars more of Government spending. The reduction in freedom, liberty, and justice resulting from these Government efforts was accompanied by further economic dislocations and loss of confidence by foreigners in the U.S. dollar as increases in the general price level, carelessly called "inflation," began to accelerate and the purchasing power of the dollar decreased commensurately. By early 1968, holders of dollar claims (paper dollars) were so eager to get rid of them that they were willing to take less and less gold for them on the free gold markets. This was reflected in an increase in the price of gold to more than the official "price" of $35 per ounce in spite of joint efforts by Western nations to sell some of their monetary gold in the free markets and thereby to keep the price from rising above the official level. These efforts were abandoned in March 1968 with the introduction of the "two-tier" market for gold.

Still, U.S. officials pursued policies of spend, spend, spend, inflate, inflate,

inflate in the name of stimulating business activity in order to avoid the "hardship" of higher unemployment that would accompany a business contraction. As AIER predicted, the inevitable "boom" excesses fostered by inflating developed and became more apparent during the late 1960's. Credit demands outpaced available loanable funds in spite of the banking system's monetization of much debt, and interest rates rose dramatically. Government limitations on interest rates payable by various sectors of the U.S. financial community encouraged the expansion of the Eurodollar market as Americans withdrew funds from U.S. banks and deposited them in foreign banks (frequently a foreign branch of the U.S. bank from which the funds were withdrawn) in order to earn a higher interest rate. The foreign branches then loaned the funds back to the domestic home office. Thus, by its regulations, the Government succeeded only in creating a wastefully circuitous route for funds to find their way to the best use. Sophisticated investors could take advantage of this route, but smaller investors were unable to do so. Result: more inequitable treatment; less justice.

Increases in the general level of prices continued to accelerate during the late 1960's. Policymakers were confronted with the awful dilemma that they have faced ever since: unless policies of financial restraint were applied, the economic distortions would increase until borrowers would become so overextended that any failure could precipitate a major collapse; however, if restraint were applied too quickly, it could so constrict demand that a downward spiral of business activity would ensue.

The recession came in 1969 when monetary authorities applied mild credit restraint, and the recession was comparatively mild. Price increases abated somewhat, but they did not decrease in absolute terms. Inflationary policies quickly were reapplied. Foreign distrust of the dollar increased, and the free-market price of gold, which had dropped back to about $35 per ounce shortly after the introduction of the two-tier market, again began to rise. An interest-equalization tax on foreign financial assets and other restrictions to discourage the outflow of U.S. dollars to foreign nations failed to "strengthen" the dollar in the onslaught of dollars created in the process of monetizing massive amounts of U.S. domestic debt. Foreign central banks bought large amounts of U.S. dollars as they attempted to prevent their currencies from rising in value in terms of the dollar. Those central banks invested their dollar holdings in the Eurodollar market, and the total of Eurodollar obligations skyrocketed.

In the meanwhile, interference with liberty, freedom, and justice of the American people had become international. In 1970, when the world was awash with international liquidity, the first allocation was made of the International Monetary Fund's (IMF) "Special Drawing Rights" (SDRs). The IMF had been created in 1944 to ease the need of nations with international payments deficits to restrain credit creation and contract their economies in order to eliminate the outflow of international reserves (mainly gold and U.S. dollars). The method was the centralization of a pool of international reserves contributed by members to the IMF, which pool would be loaned to nations experiencing "temporary" deficits. Thus, the IMF was another part of the counterrevolution – the substitution of centralized international authority for the decentralized, automatic mechanism of the international gold standard. When the IMF was created, AIER labeled it an "engine of inflation" because of the opportunity it gave profligate political leaders of nations to spend beyond their means without having to adjust promptly their domestic economies to the resultant outflow of international reserves. It has proven to be that engine of inflation. Repeatedly the pool of funds has been increased to forestall necessary adjustments. SDRs are the epitome of "funny money." They are the obligations of no one, and the obligation is to pay nothing. In a strange twist, they obligate the creditor nation to accept them in settlement of other member-nations' debts. Thus, they put the onus for adjustment on the creditor nations, those not spending beyond their means, to eliminate their surpluses by adopting the excessive spending and inflating policies of the most reckless of the major nations. This procedure for rewarding the profligate consumers and punishing the frugal producers is inconsistent with social arrangements that seem to have promoted progress in the past.

Were the Problems of the 1970's Unavoidable?

Was it too late by 1970 to prevent the sorry set of events that we now know were to follow? AIER's answer was "No." Our Index of Inflating had shown substantial excess purchasing media were outstanding, and studies of long-term exchange relationships between gold and other things suggested what might be a supportable respecification of the gold content of the U.S. dollar. We reported that a dollar of a gold content reflected in a "price" of between $70 and $140 per ounce seemed reasonable. As for the problem of excess purchasing media and the attendant drop in the purchasing power of the dollar along with the many other distortions, AIER suggested that perhaps a 10-year program for reducing inflationary policies and allowing the economy to "grow into" the excess stock of purchasing media would remove the distortions without precipitating a major recession or depression. Removal of other Government restrictions on liberty, freedom, and justice also was recommended in the confident expectation that an increase of freedom would foster a prolonged period of economic growth like that during the final quarter of the 19th century. That long period of growth never has been equaled. Moreover, it was accompanied by a downward trend of prices, and it was a time when gold redeemability of the dollar was restored following the inflationary Civil War period.

The record shows that policies opposite to those indicated as sound by earlier historical events were adopted when the weakness of the dollar and inflating persisted through 1970 and into 1971. The counterrevolution received a huge boost in August 1971 by the dictatorial actions of President Nixon in totally abrogating the promise of the United States to pay gold to foreign official holders of dollar claims and in denying Americans many freedoms by imposing mandatory wage and price controls. At the same time, the spend-for-prosperity and inflationary policies were continued. With the U.S. dollar changed from a unit of gold to a unit of paper currency, monetary officials took an even more benign attitude toward the probable consequences of inflationary policies. The weight of evidence concerning fiat currencies suggested that debasement of the paper dollar would accelerate. It did.

With price and wage controls in place, the price indexes portrayed a lessening in "inflation," but our Index of Inflating revealed that inflating was increasing. As always, wage-price controls, in attacking one of the symptoms of inflating (generally rising prices and wages), gave false signals of underlying conditions. The distortions of inflating first showed up as shortages, manipulations to accomplish by subterfuge what otherwise could have been done directly in a free society, periodic crises in foreign-exchange markets, a rising demand for credit, rapid accumulation of debt, business boom, and speculative excesses. Although the perfidious interference with liberty, freedom, and justice was taken to avoid economic contraction, all was for naught when from late 1973 to early 1975 the Nation experienced its most severe economic contraction since the 1930's.

Was OPEC responsible for the contraction? Perhaps in part, but the worst shock of OPEC was the embargo late in 1973. While that seems to have ended the expansion, the contraction was so mild through mid-1974 that many analysts were forecasting rapid expansion for the rest of that year and into 1975. In the last half of 1974, economic activity contracted sharply. With hindsight, most analysts now attribute the severity of that recession to huge excess inventories accumulated by businesses during the preceding expansion in an effort to beat expected future price increases. Moreover, as inflating proceeded during 1971, 1972, and 1973, wage-price controls were dismantled in steps and the hidden price rises became apparent as rates of increase in the popular price indexes approached and surpassed 10 percent – a new event for a period of peace in the United States. Interest rates, too, rose to double-digit numbers.

Rapid general price increases translated into rapid depreciation of the dollar. In terms of some major foreign currencies the value of the dollar fell about one-third from 1971 until 1973. The dollar price of gold increased to nearly $200 per ounce by the end of 1974. Domestically, the purchasing power of the dollar had so depreciated since 1940 that about half of the real wealth savers thought they had accumulated actually was embezzled by the subtle process of inflating.

As a reliable, long-term accounting unit, the dollar became a failure. Reported accounting profits were largely fictional because charges against current revenue for the cost of inventory sold and machinery depleted became inadequate in terms of replacement cost. Nominal wages increased, but real wages fell because of rising prices. Hostility among groups within society replaced the earlier attitude of voluntary cooperation as each group apparently concluded that it was the unjust victim of inflating. Strikes by teachers, policemen, and firemen revealed an attitude of militancy among public-service employees.

A few lessons apparently were learned from the excesses of the late 1960's and early 1970's and from the sharp recession of 1973-75. For a time after the recession ended, businessmen followed more cautious borrowing practices. Bankers, too, learned from their troubled loans to Real Estate Investment Trusts, to tanker owners, and to underdeveloped countries to be less aggressive in seeking deposits and extending credit. However, U.S. officials did not change their policies of deficit spending and their inclination to interfere in the economy.

The Government's reaction to the problems associated with OPEC's exercise of its power in late 1973 is a clear example of turning more to central authority than to the dispersed decisionmaking of the market for coping with economic difficulties. The method of freedom and justice as a way of unleashing the ingenuity of the American people in the pursuit of solutions to the high cost of energy was rejected; central control of prices and direction of product distribution and resource allocation were embraced. With what success? Germany and Japan, two countries more dependent on oil imports than the United States, allowed market prices of oil to find their own level, and their economies adjusted to the new energy situation much more readily than did this Nation. Not until President Reagan decontrolled oil prices in early 1981 did the United States get relief from the oil problem. (No doubt, the two early-1980's recessions also were factors by reducing worldwide demand for oil, but those events support the notion that inflationary U.S. policies during the 1970's worked to "validate" OPEC's price hikes.)

Our designation of inflating and our method of estimating inflating summarized in the Harwood Index of Inflating had proven useful for 4 decades when doubt about the accuracy of some components of the Index arose during the later months of the 1973-75 recession and we discontinued publication of it. We immediately undertook to cure it of its deficiencies, because as far as we are aware, it is the *only* procedure available for estimating inflating itself rather than symptoms of inflating (such as general price rises) or *possible* means of inflating (such as funding Federal deficits). Problems arose in connection with innovations in the U.S. financial system that obscure purchasing media commonly used for effecting transactions from saved purchasing media. Historically, demand deposits and currency in circulation were the main part of purchasing media in use; but beginning in the early 1970's,

negotiable orders of withdrawal (NOW accounts), share drafts on credit unions, automatic funds transfers between savings and checking accounts, and similar facilities evolved, and they serve both as respositories of saved purchasing media *and* of transactions purchasing media.

Lessons for the 1980's

When during the late 1970's, interest rates rose (along with general price increases) to upper-teen levels, the opportunity cost for holding funds in traditional forms of "money" (which paid no interest) also rose. More funds flowed to NOW accounts, and additional new accounts that had check-writing features were developed by the financial markets. Recognizing that the private market was circumventing 1930's banking regulations intended to prevent the payment of interest on checkable deposits, Congress passed and then-President Carter signed in March the "Depository Institutions Deregulation and Monetary Control Act of 1980." Among other things, that Act enabled banks nationwide to pay interest on some checkable accounts, provided for the phase-out of interest rate ceilings by 1986, and equalized required reserves for various types of accounts among all depository institutions. This was a major bow by Government to the power of markets; it recognized that market participants will do whatever is necessary to serve their own interests.

After the Banking Act of 1980 was passed, new deposit accounts developed, and balances among the various types of accounts changed dramatically. Monetary authorities were forced a number of times to respecify the types of liabilities that constituted transactions money (purchasing media in our language; M1 in monetarists' language). This confounded implementation of the Federal Reserve's October 6, 1979 announced policy switch to giving greater weight to growth rates of monetary aggregates (rather than interest rates) in its goal of slowly reducing inflationary excesses. That policy change itself was forced by market events. Until then (and consistent with the Keynesian spend-for-prosperity notion) the Federal Reserve sought to keep interest rates low (in order to stimulate investment and raise total demand) by fostering excess creation of money and "easy credit." By 1979, U.S. inflating had so raised fear of the dollar's future buying power that more and more people were willing to sell dollars for less of other things in general (reflected in rapidly rising broad price indexes), less of other currencies (reflected in a falling foreign-exchange value of the dollar), and less gold (reflected in a rising gold price in terms of dollars). After 5 decades of inflating (beginning with Roosevelt's devaluation of the gold dollar and denial of a gold convertible dollar for Americans), the Nation in 1979 was on the verge of a flight from currency, "hyperinflation," and economic collapse. We had long predicted such a day of reckoning.

But the collapse of the dollar (and the U.S. economy) was to be postponed again. Public confidence in the dollar, especially in the foreign-exchange market, has been somewhat restored by (1) the Federal Reserve's policy change, (2) slower growth of "money" from time to time thereafter to now (December 1983), (3) the election of Ronald Reagan on an economic program to reduce Government taxes, spending, deficits, and regulatory interference, and (4) economic recessions in 1980 and 1981-82 that have reduced "inflation." Some observers of these events have concluded that the inflationary era is over. We do not share that conclusion. In our view, the "anti-inflationary" monetary policies and the associated economic recessions of the early 1980's are little different from earlier "anti-inflationary" episodes. Perhaps the major difference is duration, and that probably was necessitated by the higher level of inflationary expectations that had to be ameliorated in order to restore public confidence in the paper dollar.

We do not see the fundamental changes having taken place that history teaches are necessary to have a sound economy. The Government sector in 1983 (and projected for 1984) takes a larger share of the Nation's output than when Ronald Reagan assumed the Presidency. The Government budget deficit is larger than ever in peacetime. Talk is rampant of a pervasive program of Government meddling in the form of a "new industrial policy." Prior inflationary-induced excess debt accumulation by less developed countries cannot be serviced in a noninflationary environment, and the size of the debt would bring worldwide financial collapse if the debtors were allowed to default. All of these – and more – create enormous political pressure to inflate. With the dollar still a paper currency, so that neither the central bankers (the Federal Reserve) nor private bankers have to pay their liabilities in gold, we predict that the "easy way out" of promoting more inflating again will be taken.

Indeed, our new estimates of inflationary purchasing media and the Index of Inflating suggest that both absolute inflating and relative inflating have been increasing since about mid-1981. We do not know how the inflationary excesses will be manifest (there is the possibility of Keynesian-like prosperity and security-market strength for a time), but we predict that in time the more troubling effects of inflating again will appear. When that occurs, what will the authorities do as an encore to the 1979 new "anti-inflationary" policy?

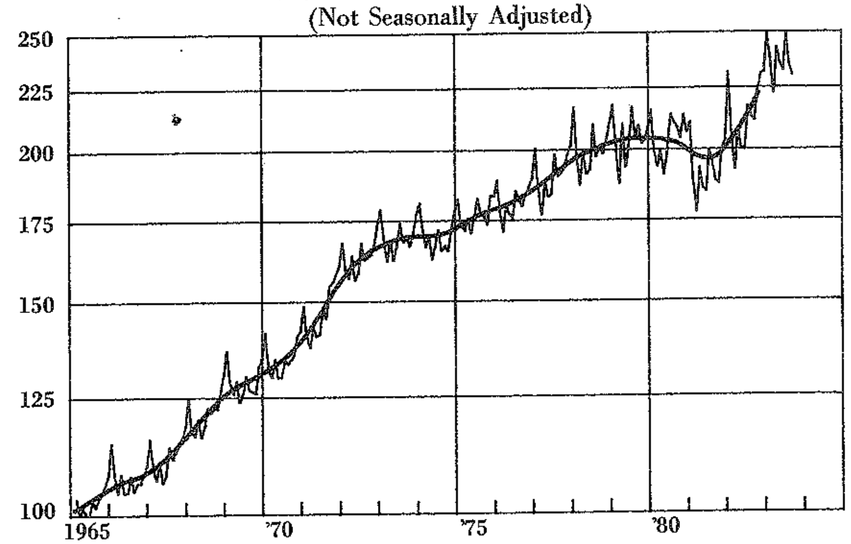
As events of the 1970's have forced authorities to change their policies from time to time, they also have forced economists to rethink the theories that were once widely accepted. Keynesianism – which said gold was a barberous relic, money mattered little, and Government could ensure continued prosperity through wise fiscal policy – lost its credibility. When introduced in the 1930's, we said it was little more than a new scheme for justifying inflationary policies and was bound to bring the Nation much economic woe if used as the basis for U.S. policy. In summarizing the implications of the new

Rational Expectations Theory on Keynesian-dominated economic models, one economist said: "It means that hundreds of laws and thousands of dissertations, books, and articles – including some of my own – have been pointless. It means that macroeconomic models that business and government rely on for their economic planning are useless except in the narrowest circumstances. . . ."*

Now "monetarism," which prescribes a fixed "rule" for central management of money, is on the ascendancy in economic theory. Yet, the idea that gold is a necessary component of a sound monetary system again is appearing in "respectable" literature. Indeed, in 1980 the U.S. Congress created a commission to study the rôle of gold in the domestic and international monetary systems. Although the Gold Commission in its 1982 *Report to the Congress* concluded, among other things, "that, under present circumstances, restoring a gold standard does not appear to be a fruitful method for dealing with the continuing problem of inflation," the debate itself illuminated again gold's monetary function, and the words, "under present circumstances" suggest a possibly different outcome at another time. Even the "real-bills doctrine," which had been relegated to the dustbin of monetary thought in the 1930's along with gold, but which we think is the second essential com-

* Willes, Mark H., "'Rational Expectations' as a Counterrevolution," in Daniel Bell and Irving Bell and Irving Kristol, eds., *The Crisis in Economic Theory*, New York, Basic Books, 1981, p. 87.

INFLATIONARY PURCHASING MEDIA IN USE
MONTHLY AND SMOOTHED*
(Not Seasonally Adjusted)



* Centered, weighted 23-month moving average.

ponent of a sound monetary system, is being studied again, albeit by only a few.†

As we shall not hazard a guess about when inflationary troubles again will become apparent, we shall not predict the rate at which gold and sound commercial banking will regain favor in monetary theory. But we do predict that they will at some time, after events still to come again prove the futility of a centrally managed, paper money system. As part of our ongoing work we shall try to advance, by scientific investigation and exposition, the case for sound money so that the worst suffering of a paper money failure might be avoided. We also shall continue to interpret the implications of ongoing monetary events, whatever they may be, from the perspective we have found useful for 50 years.

† Sargeant, Thomas and Wallace, Neil, "The Real-Bills Doctrine versus the Quantity Theory: A Reconsideration," *Journal of Political Economy*, December 1982.

V. EDUCATION PLANS

TO aid human progress, mankind now has the advantage of modern scientific procedures of inquiry to apply to the search for solutions to human social problems, including those called economic problems. In Section III we outlined these procedures and commented on their limited recognition and use to date, especially among so-called social scientists. Some fundamental economic findings arising from our application of these procedures to economic problems were described in Section IV. One of the tentative conclusions to which our inquiry to date has led us is that human progress occurs insofar as a social order provides for freedom, liberty, and justice.

Recognition of this critical relationship leads us to conclude that any attempt to force upon the general public awareness of the usefulness of scientific procedures or respect for individual freedom, liberty, and justice is a contradiction and is bound to be counterproductive. Our effort to foster human progress has the form of sharing with as many humans as we can the results of our work. If in fact our procedures and findings are useful, increasing numbers of human beings will recognize their usefulness and will adopt and support these procedures and findings. In doing so, each individual will improve his chances of reaching his desired objectives and, in combination as a social group, these individuals will increase the probability that sound economic and other decisions will be made.

Another name for communicating our descriptions and findings to others is "educating." Thus, education is as important as is research in the work of the Institute, because only by educating others to the findings and methods of the Institute is any progress from our work possible. Research in itself is sterile; only when the findings are shared with others and applied can it be useful.

The Institute's educational efforts involve mostly the publication of its descriptions of economic relationships and their findings. Our publications are written not for formally trained economists (although some of them perhaps benefit from exposure to our work) but for any American concerned enough about economic matters to take the time to read and to think seriously about this complex topic. Those expecting to gain a working knowledge of economics from the reading of one or two books, or from the study of economics for a few months, probably will not find our publications helpful. Others who want to be entertained from their reading of economic literature will be disappointed with our straightforward presentations. Those seeking get-rich-quick tips will not find them in our publications, although our work clearly has implications for personal financial dealings. The Institute's task simply is to make available to as many persons as practicable, accurate descriptions of economic relationships so that individually they might be better equipped to assess for themselves and their families and for the Nation the probable consequences of economic events and policies.

In relying for our revenue primarily on the voluntary support of many small contributors (as described in Section II), the Institute is subjected to the ongoing acid test of either ceasing operations or being helpful to enough of the general public that they are willing to finance the continuation of our work. It is a test we desire and need in order to prevent our work from becoming useless, as has that of many "ivory tower" think tanks. Thus far, such support has been sufficient to enable the Institute to survive and to grow – if only slowly – for a half century.

As part of our educational efforts, we also offer formal fellowship programs and research grants. A key part of our fellowship program is the Summer Fellowship, which consists of an in-residence study program here at the Institute from late June to early August. This program is open to individuals who plan a career in economics or a closely related field. It is designed to introduce Fellows to AIER procedures of inquiry and fundamental economic findings. Now that the role of gold in the monetary system again is receiving careful attention from academic economists, after many years when academe thought only "cranks" took gold seriously, we are considering the introduction of a Summer Fellowship program for college and university faculty members. The program would introduce them to the growing body of scholarly literature on the topics of gold as money and of sound commercial banking. We should expect that these Fellows then would reintroduce these topics in the courses they teach, which topics today remain ignored in most undergraduate classes although they are studied in many graduate courses. By these means we hope to encourage and help in the development of more economic scientists who will be able to assist mankind to achieve greater progress. Further information about Institute fellowship and research grants is available from the Director of Education.

Through the years, many individuals have expressed impatience at the plodding pace of the Institute's educational efforts. Admittedly, the process has been slow. Unfortunately, we are aware of no way to speed the process, given our limited resources and commitment to scientific procedures. We know we could garner a bigger membership, attract more financial support, receive more publicity, and more quickly influence policy if we would sacrifice restrained descriptions and limited forecasts in favor of dogmatic assertions and doctrinaire predictions. But that is not the way of science. If economic methods, theories, and policies are to be usefully reformed, we believe that proper procedures offer the most chance for success – even if decades are required to see noticeable progress.

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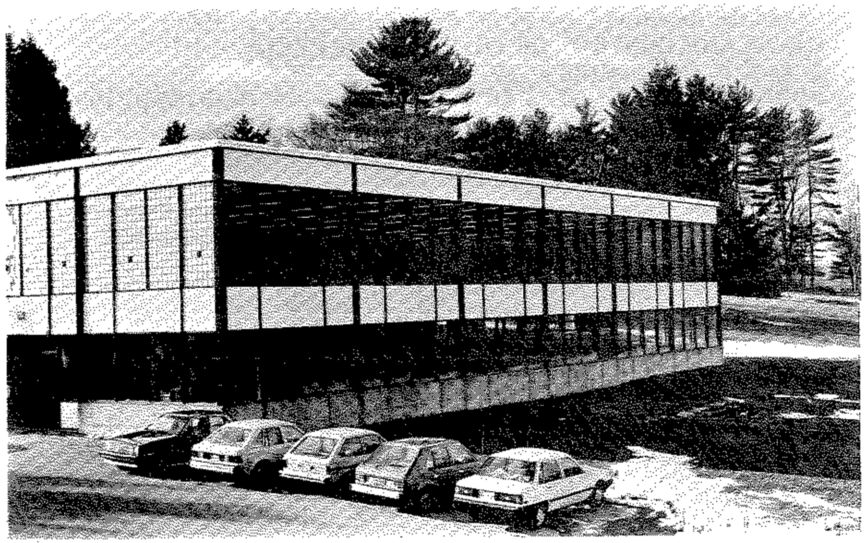

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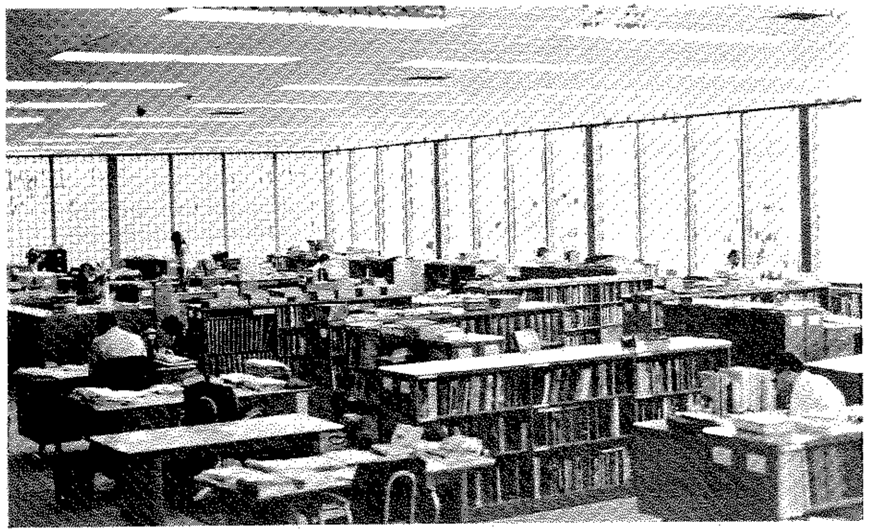

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