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The Rules of the Game and Economic Recovery

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The following is adapted from a lecture given at Hillsdale College on February 2, 2010, during a conference on the New Deal co-sponsored by the Center for Constructive Alternatives and the Ludwig von Mises Lecture Series. A version of this lecture was delivered as the Hayek Prize lecture in 2009.

The Monopoly board game originated during the Great Depression. At first its inventor, Charles Darrow, could not interest manufacturers. Parker Brothers turned the game down, citing "52 design errors." But Darrow produced his own copies of the game, and Parker Brothers finally bought Monopoly. By 1935, the *New York Times* was reporting that "leading all other board games … is the season's craze, 'Monopoly,' the game of real estate."

Most of us are familiar with the object of Monopoly: the accumulation of property on which one places houses and hotels, and from which one receives revenue. Many of us have a favorite token. Perennially popular is the top hat, which symbolizes the sort of wealth to which Americans who work hard can aspire. The top hat is a token that has remained in the game, even while others have changed over the decades.

One's willingness to play Monopoly depends on a few conditions—for instance, a predictable number of "Pay Income Tax" cards. These cards are manageable when you know in advance the amount of money printed on them and how many of them are in the deck. It helps, too, that there are a limited and predictable number of "Go to Jail"

cards. This is what Frank Knight of the University of Chicago would call a knowable risk, as opposed to an uncertainty. Likewise, there must be a limited and predictable number of "Chance" cards. In other words, there has to be some certainty that property rights are secure and that the risks to property are few in number and can be managed.

The bank must be dependable, too. There is a fixed supply of Monopoly money and the bank is supposed to follow the rules of the game, exercising little or no independent discretion. If players sit down at the Monopoly board only to discover a bank that overreaches or is too unpredictable or discretionary, we all know what happens. They will walk away from the board. There is no game.

Relevance to the 1930s

How is this game relevant to the Great Depression? We all know the traditional narrative of that event: The stock market crash generated an economic Katrina. One in four was unemployed in the first few years. It resulted from a combination of monetary, banking, credit, international, and consumer confidence factors. The terrible thing about it was the duration of a high level of unemployment, which averaged in the mid teens for the entire decade.

The second thing we usually learn is that the Depression was mysterious—a problem that only experts with doctorates could solve. That is why FDR's floating advisory group—Felix Frankfurter, Frances Perkins, George Warren, Marriner Eccles and Adolf Berle, among others—was sometimes known as a Brain Trust. The mystery had something to do with a shortage of money, we are told, and in the end, only a Brain Trust's tinkering with the money supply saved us. The corollary to this view is that the government knows more than American business does about economics.

Another common presumption is that cleaning up Wall Street and getting rid of white-collar criminals helped the nation recover. A second is that property rights may still have mattered during the 1930s, but that they mattered less than government-created jobs, shoring up homeowners, and getting the money supply right. A third is that American democracy was threatened by the rise of a potential plutocracy, and that the Wagner Act of 1935—which lent federal support to labor unions—was thus necessary and proper. Fourth and finally, the traditional view of the 1930s is that action by the government was good, whereas inaction would have been fatal. The economic crisis mandated any kind of action, no matter how far removed it might be from sound monetary policy. Along these lines the humorist Will Rogers wrote in 1933 that if Franklin Roosevelt had "burned down the capital, we would cheer and say, 'Well at least we got a fire started, anyhow.'"

To put this official version of the 1930s in terms of the Monopoly board: The American economy was failing because there were too many top hats lording it about on the board, trying to establish a plutocracy, and because there was no bank to

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hand out money. Under FDR, the federal government became the bank and pulled America back to economic health.

When you go to research the 1930s, however, you find a different story. It is of course true that the early part of the Depression—the years upon which most economists have focused—was an economic Katrina. And a number of New Deal measures provided lasting benefits for the economy. These include the creation of the Securities and Exchange Commission, the push for free trade led by Secretary of State Cordell Hull, and the establishment of the modern mortgage format. But the remaining evidence contradicts the official narrative. Overall, it can be said, government *prevented* recovery. Herbert Hoover was too active, not too passive—as the old stereotypes suggest—while Roosevelt and his New Deal policies impeded recovery as well, especially during the latter half of the decade.

In short, the prolonged Depression can be put down to government arrogance—arrogance that came at the expense of economic common sense, the rule of law, and respect for property rights.

Arrogance and Discretion

Consider the centerpiece of the New Deal's first 100 days, the National Recovery Administration (NRA), which was in effect an enormous multisector mechanism calibrated to manage the business cycle through industrial codes that, among other things, regulated prices. The principles on which its codes were based appear risible from the perspective of microeconomics and common sense. They included the idea that prices needed to be pushed up to make recovery possible, whereas competition constrained recovery by driving prices down. They held that big firms in industry—those "too big to fail"—were to write codes for all members of their sector, large and small—which naturally worked to the advantage of those larger firms. As for consumer choice, it was deemed inefficient and an inhibitor of recovery. The absurdity of these principles was overlooked, however, because they were put forth by great minds. One member of the Brain Trust, Ray Moley, described the myopic credentialism of his fellow Brain Truster, Felix Frankfurter, in this way:

> The problems of economic life were to Frankfurter matters to be settled in a law office, a court room, or around a big labor-management bargaining table . . . . The government was the protagonist. Its agents were its lawyers and commissioners. The antagonists were big corporate lawyers. In the background were misty principals whom Frankfurter never really knew at first hand . . . . These background figures were owners of the corporations, managers, workers and consumers.

One family that was targeted by NRA bureaucrats was the Schechters, who were wholesale chicken butchers in Brooklyn. The NRA code that aimed to regulate what they did was called *The Code of Fair Competition for the Live Poultry Industry*

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of the Metropolitan Area in and about the City of New York. And according to this code, the Schechters did all the wrong things. They paid their butchers too little. They charged prices that were too low. They allowed their customers to pick their own chickens. Worst of all, they sold a sick chicken. As a result of these supposed crimes, they were prosecuted.

The prosecution would have been comic if it were not business tragedy. Imagine the court room scene: On one side stands Walter Lyman Rice, a graduate of Harvard Law School, representing the government. On the other stands a small man in the poultry trade, Louis Spatz, who is afraid of going to jail. Spatz tries to defend his actions. But he barely speaks English, and the prosecutor bullies him. Nevertheless, Spatz is now and then able to articulate, in his simple and common-sense way, how business really works.

> *Prosecution: But you do not claim to be an expert?*
> *Spatz: No.*
> *Prosecution: On the competitive practices in the live poultry industry?*
> *Spatz: I would want to get paid, if I was an expert.*
> *Prosecution: You are not an expert!*
> *Spatz: I am experienced, but not an expert . . . .*
> *Prosecution: You have not studied agricultural economics?*
> *Spatz: No, sir.*
> *Prosecution: Or any sort of economics?*
> *Spatz: No, sir.*
> *Prosecution: What is your education?*
> *Spatz: None; very little.*
> *Prosecution: None at all?*
> *Spatz: Very little.*

Then at one point this everyman sort of pulls himself together.

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

This dialogue matters because little businesses like Schechter Poultry are the natural drivers of recovery, and during the Great Depression they weren't allowed to do that driving. They weren't allowed to compete and accumulate wealth—or, in terms of Monopoly, to place a house or hotel on their property. Instead they were sidelined. The Schechter brothers ultimately won their case in the Supreme Court in 1935. But the cost of the lawsuits combined with the Depression did not go away.

Regarding monetary policy, it is clear that there wasn't enough money in the early 1930s. So Roosevelt was not wrong in trying to reflate. But though his general idea was right, the discretionary aspect of his policy was terrifying. As Henry Morgenthau reports in his diaries, prices were set by the president personally. FDR took the U.S. off the gold standard in April 1933, and by summer he was setting the gold price every morning from his bed. Morgenthau reports that at one point the president ordered the gold price up 21 cents. Why 21, Morgenthau asked. Roosevelt replied, because it's 3 x 7, and three is a lucky number. "If anyone knew how we set the gold price," wrote Morgenthau in his diary, "they would be frightened."

Discretionary policies aimed at cleaning up Wall Street were destructive as well. The New Dealers attacked the wealthy as "money changers" and "Princes of Property." In 1937, after his re-election, Roosevelt delivered an inaugural address

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in which he described government as an instrument of "unimagined power" which should be used to "fashion a higher order of things." This caused business to freeze in its tracks. Companies went on what Roosevelt himself resentfully termed a "capital strike."

These capital strikers mattered because they were even more important to recovery than the Schechters. Consider the case of Alfred Lee Loomis, who had the kind of mind that could contribute significantly to Gross Domestic Product and job creation. During the First World War, he had improved the design of firearms for the U.S. Army. In the 1920s, he became wealthy through his work in investment banking. He moved in a crowd that was developing a new form of utility company that might finally be able to marshal the capital to bring electricity to the American South. But when Loomis saw that the Roosevelt administration was hauling utilities executives down to Washington for hearings, he shut down his business, retreated to his Tudor house, and ran a kind of private think tank for his own benefit. We have heard a lot about a labor surfeit in the 1930s. Here is a heresy: What if there was a shortage of *talent* brought on by declarations of class warfare?

Another challenge to the Depression economy was tax increases. While these increases didn't achieve the social equality at which they aimed, they did significant damage by confiscating too much individual and corporate property. As a result, many individuals and businesses simply reduced or halted production—especially as the New Deal wore on. In the late 1930s, banker Leonard Ayres of the Cleveland Trust Company said in the *New York Times*: "For nearly a decade now the great majority of corporations have been losing money instead of making it."

As for big labor, the Wagner Act of 1935 proved to be quite destructive. It brought on drastic changes at factories, including the closed shop—the exclusion of non-union members. Another innovation it helped bring about was the sit-down strike, which threatened the basic property right of factory owners to close their doors. Most importantly, it gave unions the power to demand higher wages—and they did. A wage chart for the 20th century shows that real wages in the 1930s were higher than the trend for the rest of the century. This seems perverse, considering the economic conditions at the time. The result was high paying jobs for a few and high unemployment for everyone else. The reality of overpriced labor can be seen in several stock phrases coming out of the Great Depression—"Nice work if you can get it," for example, was the refrain of a Gershwin song performed by Fred Astaire in *The Damsel in Distress*, a film released in 1937 at the zenith of union power.

To return to the Monopoly board metaphor, the problem in the 1930s was not that there was no bank. It was that

there was too much bank—in the form of the federal government. The government took an arbitrary approach to the money supply and made itself the most powerful player. It shoved everyone else aside so that it could monopolize the board. Benjamin Anderson, a Chase economist at the time, summed it up in a book about the period: "Preceding chapters have explained the Great Depression of 1930 to 1939 as due to the efforts of the governments and very especially the government of the United States to play god."

Relevance for Today

It is not hard to see some of today's troubles as a repeat of the errors of the 1930s. There is arrogance up top. The federal government is dilettantish with money and exhibits disregard and even hostility to all other players. It is only as a result of this that economic recovery seems out of reach.

The key to recovery, now as in the 1930s, is to be found in property rights. These rights suffer under our current politics in several ways. The mortgage crisis, for example, arose out of a long-standing erosion of the property rights concept—first on the part of Fannie Mae and Freddie Mac, but also on that of the Federal Reserve. Broadening FDR's entitlement theories, Congress taught the country that home ownership was a "right." This fostered a misunderstanding of what property is. The owners didn't realize what ownership entailed—that is, they didn't grasp that they were obligated to deliver on the terms of the contract of their mortgage. In the bipartisan enthusiasm for making everyone an owner, our government debased the concept of home ownership.

Property rights are endangered as well by the ongoing assault on contracts generally. A perfect example of this was the treatment of Chrysler bonds during the company's bankruptcy, where senior secured creditors were ignored, notwithstanding the status of their bonds under bankruptcy law. The current administration made a political decision to subordinate those contracts to union demands. That sent a dangerous signal for the future that U.S. bonds are not trustworthy.

Three other threats to property loom. One is tax increases, such as the coming expiration of the Bush tax cuts. More taxes mean less private property. A second threat is in the area of infrastructure. Stimulus plans tend to emphasize infrastructure—especially roads and railroads. And after the Supreme Court's *Kelo* decision of 2005, the federal government will have enormous license to use eminent domain to claim private property for these purposes. Third and finally, there is the worst kind of confiscation of private property: inflation, which excessive government spending necessarily encourages. Many of us sense that inflation is closer than the country thinks.

If the experience of the Great Depression teaches anything, it is that property rights must be firmly established or else we will not have the kind of economic activity that leads to strong recovery. The Monopoly board game reminds us that economic growth isn't mysterious and inscrutable. Economic growth depends on the impulse of the small businessman and entrepreneur to get back in the game. In order for this to happen, we don't need a perfect government. All we need is one that is "not too bad," whose rules are not constantly changing and snuffing out the willingness of these players to take risks. We need a government under which the money supply doesn't change unpredictably, there are not too many "Go to Jail" cards, and the top hats are confident in the possibility of seeing significant returns on investment.

Recovery won't happen from the top. But when those at the top step back and create the proper conditions, it will happen down there on the board—one house at a time. ■

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