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Why 'free market' means cannot solve the present economic crisis

by William Engdahl

Friedrich von Hayek, whose economic insanities are the subject of this article, died on March 23.

No less a figure than Prof. Horst Siebert, president of the Kiel Institute for World Economics, has entered the debate on whether Europe should have an "industrial policy." By industrial policy is meant that in which governments, along the model of Japan's Ministry of International Trade and Industry (MITI), were mandated to develop an active state guidance and support for technological advances and industrial development.

The professor argues in the March 14 *Frankfurter Allgemeine Zeitung* that one of the major dangers from the Maastricht Treaty on European union, is that, in addition to an eventual single European currency, it calls for a common European strategic industrial policy. To state the essence of Siebert's article, the only efficient regulator of industrial development must be the rigor of global unrestricted capital—free markets. He argues that any effort to place government in a position of coordinating industrial development policy, even in concert with private industry and scientific research institutions, risks returning to the black days of East European communist planned economy. In short, if you oppose the free market, you risk being labeled a closet communist.

The nub of Siebert's argument is that the state is axiomatically out of touch with the demands of the market. He argues that the dilemma of such a structural policy is "what Friedrich August von Hayek calls the 'information problem.' Industrial policy argues that the crucial industrial branches are identifiable. But state organs, be they parliaments or ministries, have no information about which products will flourish in the future." Siebert asserts, "There is a clear separation between the purpose of the state and of the economy." He doesn't clarify in what respect. We are to accept it as axiom.

Government has a key role

Profound sounding tones. The only problem with this argument is that it is wrong, if the welfare and prosperity of a nation are considered the proper object of economic policy. Presumably not through ignorance, Siebert chooses to omit the historical lessons of the great industrial development which built not only Japan, but also Germany, from the establishment of the Zollverein (customs union) in the 1840s until 1914, and again from 1948-75, as well as the United States up through the beginning of the 1960s: namely, the active state role, fostering the development of necessary infrastructure, advanced technology projects, tax and credit policies—an industrial strategy—to allow private initiative to flourish. The leading technological role of NASA in the space program for the U.S. economic advances of the 1960s is one good example.

Siebert is an exponent of von Hayek's private circle, known as the Mont Pelerin Society. It is useful to note that this organization, with its adherence to radical monetarist ideology and an almost mystical belief in the "efficiency of the market," was responsible for the economic policies of the Thatcher administration in Britain from 1979-90 (Sir Alan Walters, the late Karl Brunner), and of the Reagan-Bush administrations in America from 1981-92 (Milton Friedman, Beryl Sprinkel).

Exactly those economies which followed the ideological vogue of Thatcherism or the von Hayek free market in the past decade—most of the Anglo-Saxon world, including Britain, the U.S.A., Canada, Australia, New Zealand, as well as those ideologically influenced such as Sweden and Norway—are, not coincidentally, the very economies which are presently in the worst economic depression since the 1930s.

Taking the Siebert argument to the extreme, one could argue that, today, market efficiency shows the greatest return on investment—even discounting overhead costs such as bribing customs officials, local judges, or shooting rival gangs or innocent civilians—from traffic in cocaine or heroin. Hence, market freedom should mandate the legalization of such narcotics. Milton Friedman has argued for this openly on American television.

Oil price shock protected investments

I do not know whether Siebert goes so far as his American Mont Pelerin colleague, but his economics, above all, lack rigor or competence in the real world. I cite his example of the $24 billion investment of private oil companies into the Alaskan North Slope oil exploitation, relying not on state assistance, but rather on the efficiency of global capital markets. For Siebert, this is proof enough that his free market gospel works. Having just completed a book on the subject of Anglo-American oil politics, this writer would relish the

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opportunity to debate this with the professor in public. But no more misleading example could have been chosen to prove his point. Alaskan oil risked becoming the largest investment catastrophe in modern business history, that is, until October 1973. Only after Henry Kissinger's Middle East interventions, using the full powers of the U.S. government, detonating the Yom Kippur War and the ensuing oil embargo, and pressuring a skeptical Shah of Iran to press within OPEC for a 400% oil price rise, did the costly North Slope Alaskan and North Sea oil investments become profitable. But at what a cost to the rest of the world economy! It was a rigged game from the outset. Better another example, dear professor.

Let's take the case of the present U.S. depression. In industry after industry, the once-dominant American position has eroded over the decade of the Reagan-Bush free market dogma. In auto, manufacturing, steel, shipbuilding, and also frontier high-technology domains including computers, industrial robotics, and controlled thermonuclear fusion, Siebert's "magic of the market" has served to bring the world's largest industrial nation to its worst economic crisis in its two centuries of existence as a nation. The Bush administration rigidly insists, however, that the government is to have no role in industrial policy.

Siebert's essay provokes discussion of what the proper role of the state must be in productive credit creation. As our society is organized on the basis of a complexity infinitely beyond that of our ancestors, let alone primeval jungle beasts, for whom Siebert's Mont Pelerin dogma is better suited, the issue of how the state can bring a nation out of economic chaos and disorder is the relevant one for today.

There is a fundamental distinction economically between productive and non-productive investment. For more than a decade, the U.S. government has aggressively violated this distinction, in pursuit of privatization and deregulation, following the Thatcher model. The resulting industrial decay and eventual depression, following a run of frenzied money-making, were predictable.

The Federal Reserve System was created in 1913 by a cabal of private bankers to serve and regulate the affairs of those private bankers—J.P. Morgan, Chase Manhattan, and Citicorp, most notably. But above all, the Fed exists to serve the interests of that tiny minority, not the general public good. The little-known truth is that, though the President appoints the chairman of the Federal Reserve, the stock shares of the Fed are held by member private banks, and the most critical shares are held by the large New York money-center banks.

Thus, as Fed Chairman Alan Greenspan has bent over backward to ease credit since the onset of the depression in late 1989, his aim has not been to channel credit to needed investment in public infrastructure—highways, roads, bridges, high-speed rail, water supply, electric power grid. Rather, he has allowed the private banks to make a fantastic profit by borrowing "cheap" and lending "dear." Similarly, in October 1979, Federal Reserve Chairman Paul Volcker imposed a monetary austerity which resulted in interest rates soaring above 20%. The aim was to strengthen New York banks and their dollar-based assets. The real economy was predictably plunged into deep recession. Volcker called it "monetary discipline."

Productive credit creation

In a nationally televised 30-minute address in the United States, economist and Democratic presidential candidate Lyndon H. LaRouche outlined a program for necessary state-initiated credit creation which, if properly administered, LaRouche estimates would create 6 million new productive jobs in the economy. LaRouche proposed a direct change in the constitution of the American central banking system to reverse the depression and return to an active government role in productive credit creation.

LaRouche outlined a series of emergency economic measures, including what he calls the "Banking Reorganization Act of 1993," which would bring the Federal Reserve under the constitutional control of the elected federal government. The act is modeled on the 1790 principles behind Treasury Secretary Alexander Hamilton's establishment of the first National Bank of the United States. LaRouche's plan for a reconstituted National Bank would regulate the rapid write-off of an estimated $5 trillion of speculative loans tied to non-productive areas such as Atlantic City casinos, empty shopping malls, and so forth. The new bank would be empowered, under LaRouche's plan, to issue $1 trillion of new credit annually for targeted lending to the public and private sectors for investment in infrastructure and capital investment to rebuild the wreckage of industrial America. It is estimated that America today requires $3 trillion in investments to rebuild its core public infrastructure.

Since the end of the Second World War, a pernicious policy has gradually come to dominate Washington's official economic accounting. It was known as Gross National Product estimates of the National Income Accounts. By using strict market price, GNP methodology is inherently unable to distinguish between productive and non-productive investment. A 400% oil price shock translates into price inflation across the economy which is recorded as growth of GNP—no matter that entire energy-intensive industries such as steel are bankrupted. The LaRouche plan would ensure that a return to the original Hamiltonian idea of productive state investment were again established. This is the model on which Germany's industrial excellence was established during the last century through the work of List and others who were familiar with the Hamiltonian "American System" of national economy. Siebert would do well to spend more time grasping the genius of Listian economics than to dally at the altar of Milton Friedman's "free market." There is nothing free about it.