Trump Strategist Bannon: Austrian Economics Too Theoretical. Really?!

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Steve Bannon (shown), the top political strategist for President Donald Trump, has criticisms for both the Democrats and the Republicans, according to Robert Draper in a recent piece for *The New York Times Magazine*. Draper quoted Bannon as saying both Democrats and Republicans have difficulty getting things done:

I think the Democrats are fundamentally afflicted with the inability to discuss and have an adult conversation about economics and jobs, because they're too consumed by identity politics.

And then the Republicans, it's all this theoretical Cato Institute, Austrian economics, limited government — which doesn't just have any depth to it. They're not living in the real world.

While Bannon's analysis of the Democrats seems mostly on target, the charge that the Republicans are overly concerned with limited government or what the free market-oriented Cato Institute thinks seems off the mark — unfortunately. Sadly, most Republicans in Congress appear largely unconcerned about limiting the role of government in society. Perhaps they seem like rock-ribbed conservative free enterprisers, in contrast to the present left-wing composition of the Democratic Party; however, other than the House Freedom Caucus (an outgrowth of former Congressman Ron Paul's Liberty Caucus), most Republicans are hardly warriors for limited government.

While much could be written on the topic of Republican lack of fidelity to limited government, perhaps the most telling comment by Bannon was his dismissal of "Austrian economics."

Only a small minority of Americans even know what is meant by "Austrian economics"; however, Bannon's insistence that those who follow that school of thought are "not living in the real world" should concern anyone who had hope that the Trump administration would not repeat the economic miscues so often practiced by the American government, Democrat or Republican, for the past several decades.

Austrian economics refers to a school of economic theory associated with an economist from Austria — Ludwig von Mises — and his disciples, such as Friedrich Hayek, Murray Rothbard, and former U.S. Congressman Ron Paul from Texas. Mises first gained attention in the late 1920s when he correctly predicted the Great Depression. While other economists were foolishly predicting that permanent prosperity had arrived in America, Mises asserted that was a fantasy.

"It is clear that the crisis must come sooner or later," he stated. "It is also clear that the crisis must always be caused, primarily or directly, by the change in the conduct of the banks."

Mises explained that the banks, spurred on by the Federal Reserve System, had erred in keeping interest rates artificially low. Inevitably, there would be a "correction," as happened in October of 1929 with the great stock market crash. Stock prices lost $30 billion in one month — about the amount it had taken for the United States to fight World War I. Disastrous government policies practiced first by President Herbert Hoover, and later by President Franklin Roosevelt, then caused the sharp downturn to persist for more than a decade.

One would think that Mises would be hailed as a brilliant man — and he certainly is by many who are familiar with what Austrian economics is all about. But Stephen Bannon is not alone in refusing to acknowledge the truth of what Mises said then, and continued to preach until his death in 1995.

So, what is Austrian theory? First, it may be helpful to look at the misguided views that theory challenged in the robust economic years of the 1920s. During that time, there was clearly real economic growth, with increased wealth produced in the United States in the form of automobiles and other technological advances. This massive increase in wealth should have led to a fall in prices, thus allowing an even wider distribution of that wealth to average Americans.

But the Federal Reserve System, America's central bank that had been created by an act of Congress in 1913, adopted a policy of lower interest rates, which pumped increasing amounts of money into the economy. This injection of about 60 percent more money in the 1920s through lower interest rates kept prices "stable," or in other words, did not allow prices to fall to their natural market level. Both Hoover and Roosevelt preached the theory that high wages and high prices led to a healthy economy; however, somehow (*why* is the topic for another article) these two well-educated men had ignored the whole point as to why the Industrial Revolution had raised the standard of living: *increased production led to cheaper goods, making them more accessible to lower-income persons.*

Austrian theory recognizes that there is a "free market" reason for interest rates to drop: the public saves more. But that is not the principal reason interest rates dropped in the Roaring Twenties. Both then *and now*, interest rates have been kept artificially low by our central banking system.

Business owners tend to borrow more often and at greater amounts when interest rates are low. When interest rates are kept artificially low via central banking policies, this creates the illusion of greater wealth than actually exists. As Thomas Woods explains in his book *Meltdown*, "Forcing interest rates lower than the free market would have set them makes economic actors act as if more saved resources exist than actually do. Some portion of their new investment is

malinvestment," or investment in projects that cannot be sustained — unless fresh injections of money and credit (inflation) are extended.

Woods pointed to the housing boom as a "classic example of this theory in action. Artificially low interest rates misdirected enormous resources into home construction. We now know this was unsustainable."

What tends to happen at this point is what caused the boom — namely manipulation by the Federal Reserve to keep interest rates lower than their normal market level — is continued. This only puts the needed correction further off into the future, causing the inevitable bust to be much worse.

As Hayek noted, "To combat the depression by a forced credit expansion is to attempt to cure the evil by the very means which brought it about."

Yet, despite several examples of such boom and bust cycles in U.S. history — caused by the manipulation of interest rates, all of which have proved Mises and his Austrian theory correct — modern politicians and their "learned" advisors persist in thinking they can ignore basic laws of economics. Mises stated, "The only way to do away with, or even to alleviate, the periodic return of the trade cycle — with its denouement, the crisis — is to reject the fallacy that prosperity can be produced by using banking procedures to make credit cheap."

For the 12 million Americans left unemployed in the depths of the Great Depression — and for retired Americans today who suffer with politically-caused low interest rates for their life's savings, the young couples dealing with the high prices caused by artificial credit expansion, and business owners struggling with the periodic downturns in the economy — that would seem to be pretty "real world."

In short, Bannon would do well to actually read what Mises had to say, and make the effort to understand it. Then, instead of criticizing the wisdom of the Austrian theory (which has been demonstrated to be true in practice multiple times), he could impart some of its wisdom to President Trump.