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## **The Wizards of Washington** **by Sheldon Richman**

Remember that telling scene in *The Wizard of Oz* when Toto reveals the “great and powerful wizard” as nothing but a homunculus operating an imposing thunder-and-lightning machine? “Pay no attention to that man behind the curtain,” he bellows, not knowing enough to quit even when he’s exposed.

The government’s response to the current economic turmoil reminds me of that scene. We are assured by the awe-inspiring U.S. Treasury and Federal Reserve that if we trust them with essential control of the American economy, all will be set right. “Have confidence. We know what we we’re doing” is the gist of what they say.

Behind the curtain, however, are just a bunch of bureaucrats who couldn’t possibly put the economy right because no one can know how to do that. The required information is unavailable to them. They would be better able to give a cowardly lion courage, a tin man a heart, or a scarecrow a brain.

Sloppy metaphors to the contrary, an economy is not an engine that occasionally needs a mechanic to go under the hood to tune it up. An economy is people pursuing their preferences by engaging in endless varieties of exchanges with others while coordinating disparate plans founded on unspoken expectations. For all the “looseness” involved, it is an amazingly orderly process — when it is allowed to operate in peace and without government intervention.

Unfortunately, governments rarely let it operate in peace, and it’s not hard to fathom why. Government planning is power, and with only few exceptions, most people attracted to top government jobs want to wield power. While they are incapable of fixing an economy — if that means restoring it to its consumer-serving function — they are fully capable of skewing it to their own purposes.

Government interference with the economic process represents a substitution of political for consumer objectives. In a freely functioning economy — absent government privileges and burdens — entrepreneurs work to arrange the productive process ultimately to satisfy consumers’ subjective preferences. This idea is implicit in the very concepts *production*, *investment*, and

*labor*. Their fruits must have value in the eyes of consumers. Even Marx understood this. He wrote in *Capital*, “A thing cannot have value, if it is not a useful article. If it is not useful, then the labor it contains is also useless, does not count as labor and hence does not create value.”

### **The harm of interventionism**

Thus when government “creates jobs” by taking money from the private sector and “investing” in favored projects, it is not truly productive activity. Rather, the government has preempted the economic process, forbidding it to serve consumers so that it can instead serve the objectives of politicians and bureaucrats.

In his classic essay “The Fallacy of the Public Sector,” Murray Rothbard wrote,

One of the most important features of our economic resources is their scarcity: land, labor, and capital goods factors are all scarce, and may all be put to various possible uses. The free market uses them “productively” because the producers are guided, on the market, to produce what the consumers most need: automobiles, for example, rather than buggies. Therefore, while the statistics of the total output of the private sector *seem* to be a mere adding of numbers, or counting units of output, the measures of output actually involve the important qualitative decision of considering as “product” what the consumers are willing to buy. A million automobiles, sold on the market, are productive because the consumers so considered them; a million buggies, remaining unsold, would *not* have been “product” because the consumers would have passed them by.

Thus, when politicians and bureaucrats transfer purchasing power from the people to themselves, it necessarily is consumption by those officials and not investment in behalf of the people. It is a loss to the people, who have been deprived of the ability to devote scarce resources to what they value.

“Far from adding cozily to the private sector,” Rothbard added,

the public sector can only feed off the private sector; it necessarily lives parasitically upon the private economy. But this means that the productive resources of society — far from satisfying the wants of consumers — are now directed, by compulsion, *away from* these wants and needs. The consumers are deliberately thwarted, and the resources of the economy diverted from them to those activities desired by the parasitic bureaucracy and politicians.

Remember this when someone says that government purchases of banks’ “toxic assets” are investments rather than spending. That is wrong on many counts. First, the means of buying the securities deprives consumers of things they would willingly buy. Second, if the assets were such bargains, private investors would be eager to acquire them (at a discount) and await the day they

appreciated. Third, even if the assets later appreciate, it's not the taxpayers who will benefit. The taxpayers are not the government.

### **Crisis and power**

Thus, government intervention in the economy is inimical to consumer welfare. Yet we are in for more. President Obama's chief of staff, Rahm Emanuel, says, "You never want a serious crisis to go to waste. Things that we had postponed for too long, that were long-term, are now immediate and must be dealt with. This crisis provides the opportunity for us to do things that you could not do before." Emanuel here unwittingly affirms Robert Higgs's thesis in *Crisis and Leviathan*: government will use a crisis (real, exaggerated, or imagined) to expand its power — at the expense of the people. And Emanuel clearly grasps Higgs's corollary: when the crisis subsides, the new powers will not be shed. Some will remain in force; others will be put on the shelf to await the next crisis.

The current financial turmoil is a textbook illustration of Higgs's principle. In just the last few months the power of government has grown exponentially. The Fed and Treasury have engaged in activities they had not dared to engage in before, such as bailing out investment banks and insurance companies and buying shares in banks. The precedent has been set. Next time, such activity will be even easier.

### **Inflation and debt**

Of course, none of this will fix the economy. The federal government as of late November had committed more than \$7 trillion to the financial system in loan purchases and guarantees of various sorts. As the *Wall Street Journal* spelled out,

While the Treasury has to borrow money from the public to finance its rescue programs, the Fed doesn't. A central bank can effectively create new money by pumping funds, also known as reserves, into the banking system. The Fed is doing that now.... Not only is it pumping in reserves, it is deciding where that cash should go, through its own lending programs.

So the Treasury is using its borrowing power to move money from point A to point B, while the Fed is creating money out of thin air and dictating who gets it. This is supposed to inspire confidence in the Wizards of Washington? How can they possibly know where to put the money and what the consequences of their decisions will be?

Every dollar the Treasury borrows is a dollar the private sector can't invest in consumer-oriented projects. And every dollar the Fed creates is a shift of purchasing power from consumers to privileged interests. Ludwig von Mises and F.A. Hayek properly stressed that inflationary

monetary policy doesn't raise the "price level" evenly, but instead changes relative prices and interest rates, diverting the economy from the path it would have taken. It is redistributive.

The key to understanding this lies in grasping the function of the price system. We think of prices as simply the notation of how much we must pay for things. But the price system accomplishes far more than that. Hundreds of millions of people buying and selling, and abstaining from buying and selling, generate a system of signals — prices — to producers and consumers about relative scarcities and demand. Through this system, consumers can convey to producers their subjective priorities and entrepreneurs can invest accordingly. The result is the wealth-producing spontaneous order and division of labor that Frédéric Bastiat described.

But government in a variety of ways sends noise through this communications network. Its borrowing crowds out private borrowers, and inflationary money distorts the signals because special interests get the newly printed money sooner than everyone else.

The result is an economy built on false signals and expectations, a structure of production in which capital is diverted to proven losers (such as Fannie Mae, Freddie Mac, AIG, and the Big Three auto makers). That is hardly the route to sustainable economic growth and prosperity. Quite the opposite.

When you recall that today's economic turmoil is the direct result of earlier distortions brought about by government policies — guarantees to lenders, so-called affordable housing policies, et cetera — it is clear that ground is being seeded for the next crisis.

At our peril do we pay no attention to those men behind the curtain.

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