THE FREEMAN
IDEAS ON LIBERTY

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JANUARY
1988
VOL. 38
NO. 1

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THE FREEMAN
IDEAS ON LIBERTY

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533
President of the Board: Robert D. Love
Vice-President of Operations: Robert G. Anderson

Senior Editors: Beth A. Hoffman
Brian Summers

Book Review Editor: Edmund A. Opitz
Contributing Editors: Bettina Bien Greaves
Jacob G. Hornberger
Paul L. Poirot

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Bruce M. Evans, chairman; Thomas C. Stevens, vice-chairman; Joseph E. Coberly, Jr., vice-president; Don L. Foote, secretary; Lovett C. Peters, treasurer.

The costs of Foundation projects and services are met through donations. Donations are invited in any amount. Subscriptions to *The Freeman* are available to any interested person in the United States for the asking. Single copies $1.00; 10 or more, 50 cents each. For foreign delivery, a donation of $10.00 a year is required to cover direct mailing costs.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

The Uncertain Economy

American businessmen are frequently criticized for focusing on short-term profits, while ignoring the need for long-term planning. But, how are businessmen supposed to make long-range plans when tax laws, import quotas, regulations, and monetary policy are constantly changing? As UCLA economist Axel Leijonhufvud points out (*Money in Crisis,* edited by Barry N. Siegel [Ballinger Publishing Company], 1984):

"The product designer who can come up with a marginally improved or more attractive product, the production manager who in a good year can increase the product per man hour by a percent or two, the vice-president of sales who might reduce real distribution costs by some similar amount, are all examples of roles that have become less important to the stable functioning or survival of a corporation. Other functions requiring different talents have increased in importance. The vice-president of finance with a talent for adjusting the balance sheet to minimize the real incidence of an unpredictable inflation is one example. The creative financing artist floats to the top in real estate. But the wise guy who does a good job at second-guessing the monetary authorities some moves ahead is the one who really counts. Smart assessments of the risks generated by the political game in Washington outweigh sound judgments of conventional business risks."

For a thoughtful analysis of government-generated uncertainty, see Ridgway K. Foley's article on page 11.

To Have and to Share

"To drink coffee I do not need to own a coffee plantation in Brazil, an ocean steamer, and a coffee roasting plant, though all these means of production must be used to bring a cup of coffee to my table. Sufficient that others own these means of production and employ them for me." With these words, the Austrian economist Ludwig von Mises (1881-1973) dramatized the workings of the market.

There are two kinds of "having," he pointed

out—a direct "physical having" and an indirect "social having." A self-sufficient farmer who lives outside the market and produces everything he and his family consumes, can use his land, tools, and farm animals as he chooses. He need not share them with anyone. He *has* them in a total sense, both directly and physically.

But the individual who produces for the market must consider his customers. He may possess his means of production in the legal sense, but his customers, through their purchasing decisions in the marketplace, tell him how to use them. And, to prosper, he must share his output with them. His customers *have* the means of production and the use of these means in the social sense.

This system of *having*—the figurative sharing of the tools of production among producers and consumers—has led over centuries to a complex system of finely specialized production and trade. This complex system furnishes us with goods, services, cultural benefits, and leisure, unknown to our ancestors, unknown to the self-sufficient farmer.

If something goes awry with this system, we often blame producers and ask government to force them to change their ways. Now it is true that a producer may misjudge the market. He may misread the directions of consumers and produce something they will not buy. But the consumers have the upper hand. If a producer fails to respond promptly to the wishes of consumers, they will take their purchases elsewhere, and he will soon be out of business.

Through the process of social *having,* consumers over the years have led producers to manufacture automobiles instead of carriages, to produce electricity instead of candles, to make ready-to-eat breakfast foods, cooking mixes, easy-to-care-for clothing, electrical tools and appliances, and so on. No producer is so big or so powerful as to be immune from the wishes of consumers.

—BBG

Saudi Wheat

While the U.S. government has spent billions of dollars in trying to make the United States "energy independent," the Saudi Arabian government has expended billions of dollars in trying to make Saudi Arabia "wheat independent." Dennis D. Miller reports in *The Wall Street Journal* (September 3, 1987):

"In 1981 [Saudi Arabia] grew only 187,000 metric tons of wheat, importing the rest of its needs. Now self-sufficient in wheat, Saudi Arabia grows nearly two million metric tons a year.

"But that self-sufficiency came at the cost of giant subsidies. . . . The Saudi government pays domestic growers $1,000 a ton for wheat that could be bought on international markets for $80. In other words, Saudi Arabia paid $2 billion for wheat it could have bought for only $160 million. . . .

"Of course, Saudi Arabia offers the same reason, national security, that the U.S. offered in the 1950s for its quotas on petroleum imports. And as the U.S. policy accelerated the rate of depletion of U.S. petroleum reserves, the Saudi policy is accelerating the depletion of Saudi Arabia's water."

Hyperinflation Threatens Brazil

by Lawrence W. Reed

Imagine a place where prices of nearly everything change by the week—and always upward.

Coffee up 50 per cent in two months, while a McDonald's hamburger more than doubles. Hotel rooms rise 110 per cent in just 30 days. Supermarket employees spend half their time at the shelves—replacing old price stickers with new ones. Restaurant menus wear thin from the frequent erasures of prices penciled in. Interest rates for a one-month bank loan—25 per cent—are higher than what Americans pay on their credit cards in a year.

This is Brazil, a South American giant gripped by runaway inflation that threatens to sink both its economy and its fledgling democracy.

For ten days in April 1987, I examined hyperinflation in Brazil's vast, beautiful, critter-infested steam bath we know as the Amazon region. Far from the country's monster cities of the south (São Paulo alone boasts a population of 15 million), I talked to dozens of people in three towns: Belém, a port city near the mouth of the Amazon with a population of a million; Santarém, a town of about 100,000 people 300 miles upriver; and Alter do Chao, a village of about 1,000 on the Tapajós River, about 30 miles from where the blue-green Tapajós flows into the muddy Amazon at Santarém.

The Amazon rain forest is an exotic place for any activity, but it can be uncomfortable for someone accustomed to a dry climate. Water thickens the air and drenches the earth in superabundance.

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One-fifth of all the fresh water on the planet flows through the mighty Amazon. As it pours into the Atlantic, it drives back the salt water of the ocean for more than 100 miles.

Ocean-going ships can navigate for 2,300 miles up the river's 4,000-mile length. More than 1,500 species of fish inhabit the Amazon and its 1,000 tributaries, in a basin which drains an incredible 2.5 million square miles of mostly jungle territory.

But water isn't the only thing of which this nation of 135 million seems to have more than enough. It's drowning in paper money, too, which explains why the value of the stuff plummets with each round of price hikes. The administration of President José Sarney, an ill-fated one from the start, is getting most of the blame for it.

In 1985, 21 years of military rule ended with the election of Tancredo Neves to the presidency. Before ever taking office, however, Neves died.

His vice-presidential running mate was Sarney, a poet and politician of little note who suddenly found himself wrestling with the accumulated economic problems the military had willingly deserted. He succeeded in making them worse by boosting public spending and printing more money to help pay for the 50 per cent of Brazil's gross national product that the government was consuming.

By early 1986, inflation in Brazil was running at an annual pace of 400 per cent. In February of that year, Sarney startled the nation with a dramatic announcement: To end the inflation, he was freezing wages and prices and reforming the currency. Three zeroes were dropped from the old "cruzeiro" and a new money, the "cruzado," was introduced.

While the freeze was in effect, the government ballooned the spending of the public sector, fostered a yawning budget deficit, and tripled the money supply.

Sarney "deputized" the nation's housewives to report on price violators and sent swarms of armed men onto cattle ranches to force owners to sell their beef at fixed prices. Goods vanished from store shelves as black markets flourished. It was like clamping a lid on a boiling kettle and turning up the heat simultaneously.

The whole thing blew up in February 1987, as the president was forced to lift the controls and, in a move that sent shock waves throughout the world's financial community, suspend interest payments on most of Brazil's $110 billion external debt.

The economy seems to be careening toward an abyss, with no one sure of what the future will bring. The prestigious financial magazine, *The Economist* (February 21, 1987) put it this way: "Brazil's economy is going downhill so fast it may jump the rails."

Talking to consumers and vendors in Belém's famous Ver-O-Peso Market, I discovered widespread skepticism about the government's inflation figures. Rather than the 400 per cent officials proclaim, the consensus in the street is that the real rate is much higher.

"The clothes I would like to buy are three times in price what they were last month," one woman complained bitterly. And like everyone else I spoke with, her wages had not kept pace, in spite of the widespread practice of "indexing" wages to the inflation rate.

"Business is way down," lamented a seller of hammocks, "and with interest rates at 25 per cent per month now, I can't afford to borrow anymore." He blamed the collapse of his customers' purchasing power for the loss of business.

"No one saves and no one plans for anything beyond today," another shopper told me. "As soon as you earn cruzados, you get rid of them, either for dollars or for something that's real."

The inflation seems to have accentuated class divisions. A common complaint is that "the not-so-rich are getting poorer while the rich hold their own or get richer."

"The rich can find ways to protect themselves, but inflation is doing to the poor and middle class what the piranhas of the Amazon do to a cow in the water," a vendor of wicker baskets said. Piranhas are those carnivorous fish with teeth like a newly sharpened saw and a disposition to match. Schools of them have been know to clean a live cow to the bone in half an hour.

Labor strife and civil unrest appear to be on the rise as a consequence of the deteriorating economy. Some residents spoke of mutiny on the railroads because of a rail strike. Dockworkers are threatening to shut down Brazil's port cities. In the banks of São Paulo, an average of 13 assaults per day occur against bank employees. Rumors of a military coup

are on the rise throughout the country.

In Santarém, I gathered detailed price information on several dozen items. "What did this sell for one month ago, and what is its price today?" I asked many of the vendors. Here's a sample of what I found:

"Glymiton," a popular liquid vitamin supplement: from 24 to 60 cruzados (about 26 cruzados equals $1); a one-kilo roll of twine: from 111 to 390 cruzados; a cup of mineral water: from 2 to 5; a spool of fishing line: from 60 to 90; and one kilo of meat: from 20 to 70.

Businessmen complain of shrunken inventories and shortages because of the evaporation of credit.

"We used to get supplies and pay for them 30 days later," a hardware store owner told me. "Now," he said, "everyone wants cash up front."

"It's ironic," a restaurant manager said, "that my suppliers demand immediate payment from me in this worthless paper, only to turn around and get rid of it themselves."

At the Aparecida Hammock Factory in Santarém, the best hammocks of the region are made. Automation hasn't come to this place yet. The hammocks are hand-woven on giant wooden looms by craftsmen who work with lightning speed over the intense clacking of fast-moving shuttles. Profits from sales are given to the Catholic Church to support social welfare programs. I asked the manager how inflation has affected the business and heard a familiar story.

"We have been hit hard," the manager said. "Tourism is down and even local people aren't buying like they used to. There are needy people who depend upon our success here who will have to do with less this year. It's sad, but what else can we do?"

When asked where things are going from here, everyone expressed either complete uncertainty or outright pessimism.

"These problems represent the worst crisis in our memory. We have no way of knowing what lies ahead," a hotel manager said.

In Alter do Chao, several people suggested that the main cause of the inflation was the government's massive external debt and that the solution was for Brazil to go further than Sarney's suspension of interest payments and cancel the foreign debt unilaterally and entirely.

Some blamed the United States for "suckering" Brazil into the debt dilemma in the first place, but anti-American sentiment did not seem to be much a part of people's thinking anywhere I traveled.

One of the few enterprises that the inflation actually may be helping is gold prospecting. In fact, Brazil is in the midst of one of history's greatest gold rushes.

Nearly half a million "garimpeiros"—individuals working with little more than a pick and shovel or a pan at the riverside—hauled out nearly 80 tons of gold from the Amazon region last year. The Brazilian minimum wage of $70 per month does not affect them, for they earn whatever the gold they find fetches them, and not an insignificant number have made a fortune.

I talked to one of the officials at SUDAM, the government agency that supervises the development of the Amazon area, about the gold discoveries. The richest find, in a place known as the Serra Pelada, "may solve Brazil's debt problem one day," he confided. "If the gold doesn't do that for us, maybe the oil will; we think we are sitting on a vast sea of oil here in the Amazon."

It's hard to imagine enough gold or oil to bail Brazil out of its present difficulties in time to prevent upheaval. This is not an economy with a lot of time to work on its troubles. The specter of worsening inflation, depression, and political turmoil clearly stares it in the face.

Sadly, the Brazilian government seems to have learned little from the last two years of chaos. In June 1987, it announced a new program which includes another round of wage and price controls. That same month, the money supply increased 28.8 per cent.

This is not the first hyperinflation the world has witnessed. It isn't the first Brazil has had, either. But seeing it firsthand and sensing the pain and confusion it engenders make one wonder why it has to happen at all. Surely one of the most enduring lessons of economic experience is that drowning a nation in paper money always wrecks the currency and the economy along with it. It's a lesson Brazil is learning now in a most painful way. □

Hyperinflation: Lessons from South America

by Gerald J. Swanson

How would you like to live in an economy without memory, where you don't know the price of anything day to day or the value of the wage you are paid? That's what it's like under hyperinflation. In Argentina, supermarket prices are increased twice daily. During the two weeks we were in Brazil recently, interest rates rose 100% from 330% to 430%. Bolivia's demand for money is so great that its third largest import is currency.

Inflation, to say nothing of hyperinflation, seems to be the forgotten bandit of the eighties. Inflation was once the chief scourge of every respectable U.S. economist. Today we seem to have other things to worry about: pockets of severe unemployment, a lack of competitiveness internationally, the fear of a recession, even the possibility of disinflation.

The chief reason inflationary concerns have abated is that, contrary to traditional economic theory, the huge U.S. federal deficits of recent years have not yet translated into spiraling prices. Until this decade, the postwar years had demonstrated a direct correlation between deficits and inflation. When deficits rose, price and interest rate increases were sure to follow. During the past six years, however, the annual deficit has almost tripled, with the national debt almost doubling, but nominal interest rates have actually fallen.

Whatever the reason for this aberration, we can consider ourselves fortunate. But for how long? Most economists would argue that the trend is simply not sustainable. South American countries such as Argentina, Bolivia, and Brazil—all of which have suffered annual inflation rates into the triple digits in recent years—offer conclusive proof that no country can indefinitely get away with spending more than it makes. The United States has something to learn by the plight of these countries. It would be a mistake to write them off as hopelessly backward, having no relevancy to such a powerful, sophisticated economy as ours. Argentina as recently as the 1920s was the fifth most productive nation in the world. Now it is 70th, with hyperinflation the major culprit.

At a critical juncture, Argentina, Bolivia, and Brazil were not willing to bite the bullet and take the steps necessary to prevent high inflation. Make no mistake about it, neither is the United States. We all seem to share a love affair with the hot fudge sundae diet; the notion that we can eat as much as we like without getting fat. But eventually the piper has to be paid. Increasing the amount of currency circulating in an economy in order to pay off debt, without increasing production, will inevitably lead to higher prices. In each country we visited, large deficits and high inflation go hand in hand. And when runaway inflation starts, it moves quickly . . . in a matter of months, or even days!

To a certain extent, it is the fluctuation in inflation rates that is difficult to live with, rather than the rates themselves. Argentina learned to cope with 100% annual inflation, but when it rose to 500% the result was virtual

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chaos. In the United States we've become accustomed to 5% inflation, but a sudden increase to 20% would profoundly change our economic realities. In fact, even 5% took some getting used to. When President Nixon imposed wage and price controls in 1971, the national inflation rate was a whopping 4.7%.

The Consequences of Hyperinflation

What would life be like in the United States with an inflation rate of 20% or more? South America offers a number of clues. At one time in Argentina, a pair of shoes cost as much as an entire steer. With hyperinflation, prices cannot be used as benchmarks for decisions, since yesterday's prices do not offer any relevancy for today. In fact, it isn't unusual for South American shoppers to see the price of bread increase between the time they enter a grocery store and the time they leave it. Savings lose their value. The only incentive is to spend. Paychecks are cashed immediately and turned into hard goods like washing machines, refrigerators, and radios. And that's assuming they are available. Consumers are forced to pay cash for everything, including homes. Above all, political and social certainty is lost.

In the United States we are accustomed to stability. We know that if today $300 is a good price for a 19-inch color television set, it will be an equally good price tomorrow. Not so in the South American economies we are studying. Beset by hyperinflation, it is nearly impossible for individuals to judge their status in life, since status is so closely related to the control over what they are able to consume.

As a political problem, inflation is much more illusive than, say, unemployment, which simply provokes a call for more jobs. Citizens don't necessarily demand an end to inflation, only to the personal hardships that result. Once wages are tied to prices so that people can be assured that their purchasing power is not damaged, they are usually satisfied. In that case, another problem actually arises when inflation is temporarily curbed and wage increases are halted. Workers tend to feel they are worse off when their monthly paychecks no longer increase routinely. Governments also become accustomed to inflation, using it as an all-too-easy way to lower their outstanding debt.

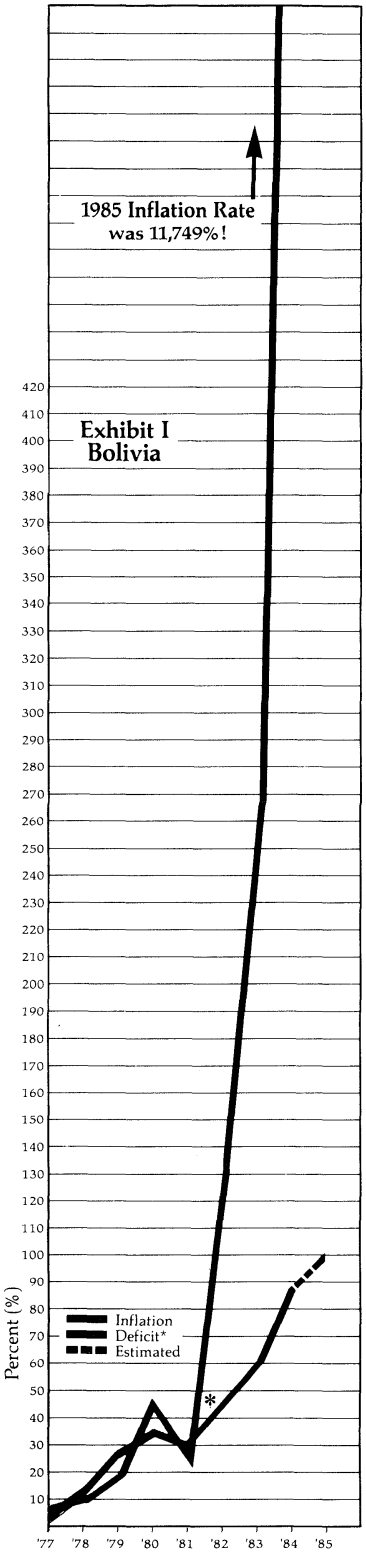
In these three South American countries hyperinflation has created more wrongs than legislators can put right. In order to protect industry, governments have been known to close their borders, which might help domestic companies in the short-term, but makes long-term competitiveness impossible. Unchecked hyperinflation inevitably plays havoc with an entire nation's standard of living. The need to survive begins to dominate individual actions, making long-term planning impossible. During hyperinflation, short-term is considered three days; long-term, two weeks. According to a top executive at Banco Palmares, "The name of the game in terms of planning during periods of high inflation is guessing what ways the government is going to try to correct their bad choices."

For individual businesses, good management is always a crucial ingredient for success. We found that during hyperinflation it becomes even more critical. New information must be absorbed rapidly, because today's political or monetary event can negate yesterday's wise business decision. In Brazil the government recently gave approval to automotive suppliers to increase the price of stainless steel by 60%. Such business decisions are needed to reassess inventory levels and production scheduling. A thorough knowledge of financial and currency markets is vital, since managing a company's money could become more important than increasing sales or even productivity.

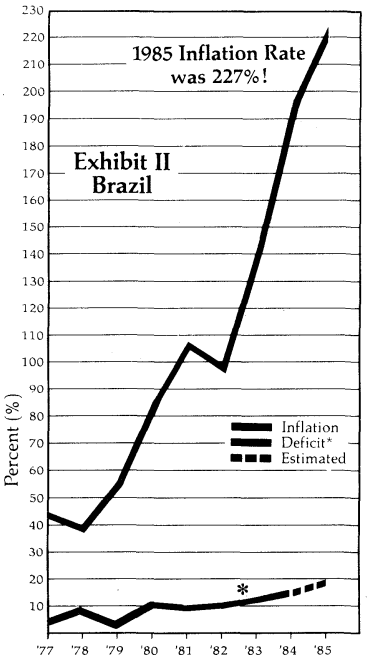
During high inflationary periods, managers turn from production management and long-term planning to financial arbitrage in order to make short-term profits by borrowing dollar denominated funds and lending them in local currency. Many South American companies invest their money in other countries, or at least place their assets in a more stable currency, which in the past has been the U.S. dollar.

Some of the most successful South American companies make collections in seven days, while delaying payment for thirty days or longer. Prices are increased rapidly, and inventories are often built up and warehoused, with expectations of selling them in the future at substantially higher prices. Other South American companies cope with hyperinflation

HYPERINFLATION IN BOLIVIA, BRAZIL, AND ARGENTINA



*Includes net lending by public sector
SOURCE: International Monetary Fund



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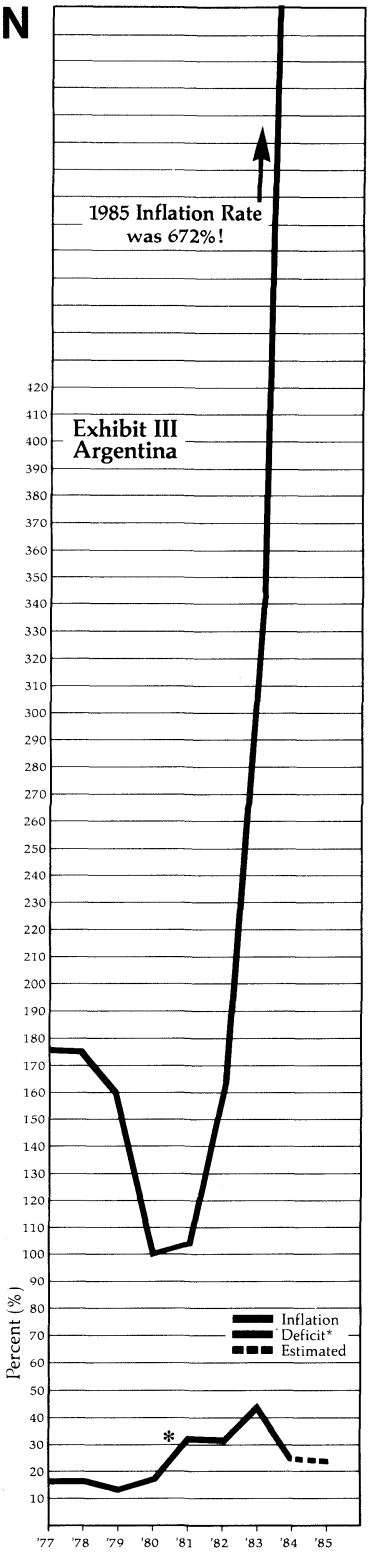

*Includes net lending by public sector
SOURCE: International Monetary Fund

through a strategy of vertical integration. In other words, by acquiring raw materials and production and distribution facilities, some concerns have been able to minimize the impact of price fluctuations, as well as government regulations.

Because events occur so rapidly under hyperinflation, those companies who can maintain their flexibility are best off. In many instances, a one-day delay in making or implementing a decision can be devastating. Often there isn't time to put orders in writing, so effective oral communications are vital. But at some point flexibility becomes the antonym of stability, and taken to its extreme creates chaos. How is a Brazilian firm, faced with an annual interest rate of 70% in November of 1986, supposed to make a proper investment decision when 90 days later the actual interest rate on loans soars to 550%? Neither individuals nor businesses can be heavily leveraged since interest rates are so unpredictable. It is enough to cause even the best laid plans to fall apart.

Once hyperinflation becomes a reality, politicians inevitably succumb to the lure of legislating it out of existence. During the past decade, Argentina, Bolivia, and Brazil all at one time or another addressed their hyperinflation problem with the simplest of solutions; they outlawed it. While government intervention often has a short-term salutary effect, making it irresistible to politicians, in the end all governments—including our own—have had to conclude that more fundamental solutions are needed to attack the root of the problem, not just the symptoms.

In 1986, President José Sarney of Brazil, in an attempt to do something dramatic about an inflation rate that threatened to soar to 500% or more, instituted an anti-inflation program that froze prices, controlled wages, and lopped three zeroes off the Brazilian currency. The plan succeeded in temporarily curbing inflation, but higher prices were quickly replaced by other problems. Severe shortages of daily necessities such as eggs, meat, and milk developed. Black markets quickly filled the vacuum, resulting in higher prices that didn't show up in official inflation figures.

White-collar crime inevitably increased as well, as a never-ending spiral began, with the government implementing a maze of regulations and citizens just as quickly developing innovative strategies to evade them. One distributor of heavy machinery told us that because used equipment is not subject to wage and price controls, he routinely leases for a month or two, then turns around and sells the equipment at twice its original price. Many companies get around wage controls by giving their employees loans that are not expected to be repaid. In all three South American countries we are studying, this kind of subterfuge, necessary as a means of survival, gives a sense of legitimacy to breaking the law, threatening a nation's moral fiber. "Inflation," a top South American officer of the Bank of Boston told us, "is an immoral tax that leads to immoral values."

Because hyperinflation can so easily become a way of life, the best—some might say the only—foolproof solution is to avoid it in the first place. Once underway, hyperinflation can only be thwarted by a painful reduction in government spending and by a halt to the printing of money not backed by the production of real goods and services. As the noted author Peter Drucker likes to say, "You can't consume what you haven't produced."

Hyperinflation is by no means a certainty for the United States, but we have managed to create conditions conducive for its arrival. In investigating what the lessons from South America can teach us, we have taken a "What if?" approach. As a further caution, however, it is important to note that in coping with hyperinflation, South America has had one weapon at its disposal that would be unavailable to us. At least these countries have a world currency to fall back on. The U.S. dollar provides them with some measure of stability. But in the event of hyperinflation in the United States, what currency could we turn to? □

Invasive Government and the Destruction of Certainty

by Ridgway K. Foley, Jr.

Law exists. It exists in the inexorable rules of consequence which govern the universe, including the inescapable rules attendant upon human action. It exists in positive or man-made rules and orders imposed by human beings, acting singly or in concert, upon other men.

Men search for justice as a quality of law in both senses of the term. If a precise and acceptable definition of law has eluded scholars and students, so also have the quality and the essential characteristics of justice proven chimerical. Attempts at definition often produce tautologies; attempts at analysis often bring forth murk. Solutions to such eternal and complicated inquiries sometimes commence with simple beginnings, and this essay addresses one simple element of justice prevalent in the common law tradition, the requirement of predictability.

I. Predictability as an Aspect of Justice

A commonplace tautology equates justice with fairness, without any feint at content or elucidation. Nonetheless, "fairness" in the common law tradition gives birth to the beguiling beauty of equality. Equality, in the guise of Cain, cultivates a leveling egalitarianism, quite apart from sound tradition or good sense. Equality, in the garb of Abel, calls for like treatment in similar situations: it is "fair" or "just" if commoner and king each must keep their uncoerced promises, avoid trespassing upon the next-door neighbor's land, and restore gains secured by deception and malevolence. The grand phrase, "equality under the law," properly conveys no more than this notion.

Certainty represents an essential component of this sort of fair or just behavior. Occupants of all stations in life start legally equal if each individual understands that similar responses will follow like acts or omissions. The common law participated in a sentiment that every man should know the law and govern his actions accordingly. This presumption—less a fiction in the fifteenth century than in the twentieth—obviated any defense of the unintended consequence; one could not avoid an unpleasant outcome by the subjective assertion that he did not understand his act to be unlawful, or that he did not contemplate a specific binding result. Derided by some modernists as unduly formalistic, the certainty of the common law allowed men to organize their activities and to accommodate their behavior to regular, common, known rules of order, similar in concept to the natural rules of order of the physical and praxeological universe.

II. Two Aspects of Certainty

Each individual participates in a search for certainty. The desire for predictable consequences inheres in each of us. Men cannot function in a random world; a rational aspect compels us to behave in a manner consonant with anticipated results. Hence, if we lived in a

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universe where the sun rose in the east one morning, in the west the next midday, and not at all during a third discrete period of time, none of us could carry on an existence bearing any semblance to life as we know it. If our actions produced highly irregular results, if our attempts to communicate afforded outrageous responses, if our physical world displayed no orderliness, all sanity would disappear forthwith. Order, regularity, and certainty represent necessary touchstones for human endeavor since development and achievement presuppose a natural order and a capacity to cope with, and learn from, our nature and our world.

Nonetheless, consider this countervailing truth: It is possible, indeed likely, to seek a predictability beyond our ken. If men possessed perfect hindsight and foreknowledge, if they could be "as gods" (Gen.3:5), a perfect predictability, an absolute certainty, would appertain. Each actor would understand causality and responsibility perfectly, and each act would bring forth precisely intended results. While such a utopia would not need to deal with the unintended consequence and with the thwarted expectation, the issue of moral conduct would remain to perplex that supposed society of perfect knowledge. A presupposition of absolute certainty need not necessarily incorporate an assumption of propriety: an all-knowing being could will to destroy or enslave his neighbor as the tyrants of the twentieth century have so amply demonstrated.

Of course, no such perfect knowledge appertains in the real world. One is tempted to add that no unflinching regularity appears in our life and in our world; to yield to such a temptation is to suffer seduction by a pervasive siren. Analysis compels the student to differentiate the orderly natural world from the imperfection of the human actor. The natural order consists of perfect regularity by definition: It is rational and not random, and effect follows cause in an inexorable fashion. Human behavior—part of that natural universe of things, forces, and events—likewise calls forth predictable and certain results.

The sticking point resides in the finity of mankind: to turn Niebuhr's thought counterclockwise and to render it more accurate, we are "disorderly men in an orderly universe." Our world, including the results of our activities, is perfectly predictable, yet our knowledge lacks such perfection. We assess historical causality poorly, if at all; is it any wonder that we consistently skew our predictions for the future? If any individual understood the past and could comprehend the future, he would achieve unparalleled material success: Such a lawyer would win every case and receive both prompt and full payment of his fee; such a physician would cure every patient, for he would avoid the incurable and the noncomplying; such an investor would purchase only stocks that soared, and he would sell them at their zenith.

The jurisprudential concept of certainty, then, must be perceived against this curious backdrop of human duality. Man requires regularity, yet a quest for absolute certainty proves to be a vain and unproductive act. An appropriate philosophy of law must accept the inherent regularity and perfection of the natural law of cause-and-consequence; concurrently, it must assess the role of a man-made law (posited rules and orders) designed to govern human beings who cannot survive in a random, rule-free world, and who crave predictability even to the point of impossibility, given man's flawed nature. Moreover, the scholar must never overlook the flawed nature of the *maker* of positive law: no man possesses any demonstrable edge over others in the management of human affairs other than his own!

Hence, the issue of legal certainty thrusts an incredibly complex equation before us. Review these factors, from the myriad which concatenate to cause our perplexity:

(1) An orderly natural universe of great complexity;

(2) Myriad individual actors inhabiting that universe, exhibiting these traits, among others:

(a) Incomplete knowledge

(b) Variable knowledge among members of the species

(c) Positive and sinister motives

(d) Inability to function in a random environment

(e) A desire for absolute certainty;

(3) A necessity for positive rules and orders to allow societal development, e.g.,

resolution of disputes and prevention of aggression;

(4) A disharmony between some positive law and the overriding natural law;

(5) The creation and application of positive law by individuals beset with the very limitations observed in point 2 above.

III. Common Law and Continental Tradition: A Comparison

One salient inquiry within this complicated matrix is whether, and to what extent, positive law provides, and ought to assure, predictability. Once again, recourse to the history of our common law affords essential insights. The codified Continental tradition differs mightily from the common law in several particulars, e.g., a professional class of decision-makers, an absence of community adjudicators, a strict bureaucratic formalism, and a denial of the individual rights tradition.

For our present purposes, the overweeningly remarkable and disparate attribute of the Continental system of jurisprudence appears in the imposition of pre-existent and detailed codes of conduct upon a society already fettered by the absence of individual decisional rights and by the presence of control by a professional adjudicatory and administrative class. Most systems of law outside of the Anglo-American mainstream proceed from the premise that all power inheres in the state; the state may cede some powers to inhabitants and perhaps label those choices "rights," but the power to convey incorporates the power to reclaim. The state in this conceptual framework prescribes and proscribes human activity by means of detailed codes, edicts, and decrees, customarily written in the more advanced nations, emanating from the sovereign monarch or legislative body. In essence, the modern codifiers differ little from Hammurabi, Justinian, and Napoleon.

Clearly, the Continental practice calls forth many conceptual and practical difficulties. In the present context, pervasive codes establish the apex of formalism. Human beings must act, or refrain from acting, precisely as set down by the single or collegial dictocrat. The administrator represents the worst of bureaucratic myopia: If the code contains no specific directive, activity must cease, for the state cannot countenance interstitial innovation. Prior restraint cuts off the chain of creative consequence, grubbing out the bud of change.[1] No matter that human frailty prevents any king or parliament from anticipating all possible (or even likely) choices and events, and from setting forth clear and wise rules governing all related circumstances in advance; one fact holds invariably true: Six millennia of recorded failure has not diminished the social tyrant's zeal significantly.

Simply put, the Continental system at its most zealous represents the climax of the human predilection for perfect certainty observed heretofore. Perversely, that quest for predictability proves useless: A codified world may be sterile, dull, and uncreative, but it certainly is not necessarily predictable, except to the extent that stultifying positive law always impedes human creativity and betterment.

Common law theory proceeded from radically different conceptual premises. In the first place, an evolving concept of natural, individual rights early eroded the authoritarian and absolutist English monarchy. True, Great Britain suffered under venal tyrants and false doctrines, in similar fashion to other nations. Nonetheless, at least as early as the Magna Carta, the subject intruded upon the sovereign's self-proclaimed habitat, and compelled a declaration of rights quite apart from privileges transitorily ceded by the state.

At least five centuries witnessed the ebb and flow of the struggle between power-corrupt demigod and resistant citizen. From the Magna Carta to Lord Coke and beyond, the individual slowly established the theoretical base from whence emerged the individualistic political theory of John Locke and the incipient market economic analysis of Adam Smith. While it remained for the fledgling United States to give full bloom to the fragile flower of liberty, certainly the nineteenth century witnessed the blossom throughout much of the Anglo-American world, in thought if not completely in deed.

In the second place, the common law tradition proceeded upon tenets more fearful of prior restraint than the Continental premise. The common law operated on the notion that

law existed, to be found by the judge and applied to concrete situations and real disputes. Certainly, English Parliaments enacted statutes, and British administrators provided some desultory regulation, but for centuries the common law decried pervasive codification as unworkable and unwise. Instead, the common law permitted free development of human choice without inhibiting pre-existing rules; when the interests of two or more individuals appeared to collide, and the parties could not settle the matter amicably, the dispute was brought before one of the king's courts for final resolution.

The judge sought to adjudicate by reference to pre-existing general principles which he applied to the case at hand; the jury—a device rooted in the Saxon Witan and significantly different from any institution in the Continental scheme—evolved as the body which applied the community standard of justice to the resolution of factual disputes. Unlike the Continental counterpart-edifice, the jury arose from the community, served its purpose, and returned to its daily life; the judge gained office after service at the bar or in other distinguished roles; neither jury nor judge represented a professional class of decision-maker in the mode of the rest of Europe.

IV. The Decline of Juristic Certainty

At the turn of the twentieth century, the jurisprudential analogue to John Dewey and John Maynard Keynes commenced a campaign of derision against the common law tradition. The Instrumentalists, led by Oliver Wendell Holmes, Jr., Karl Llewellyn, Roscoe Pound, and Lon Fuller, railed against "formalism" and in so doing subverted the unique Anglo-American system so carefully constructed over the centuries. From shallow beginnings, the Instrumentalists seized control of the robes in less than a half-century; today, save for a few splinter movements of little merit and less persuasion, the Instrumentalist revolution is complete[2] and few thoughtful voices of rebuke can be discerned above the babble.

The Instrumentalist attack focused upon legal method and produced a shaky and unpredictable relativism in place of the substantial certainty unique to our heritage. The Instrumentalists criticized their "formalistic" precursors for dryly logical reasoning, for an internal legal symmetry borne of predictability, and for their perceived indifference to "social effects." As a result of this frontal assault upon the established order, the radical realist substituted sociology for jurisprudence and *ad hoc* jural orders for predictable results. In the course of this enterprise, the law has become a gigantic game show, with the prevailing litigant resembling the successful contestant capable of guessing correctly if fortuitously.[3]

Pertinent to our concern with certainty is the Instrumentalists' criticism of what they pejoratively termed "the theory of legal abundance." A pinion of common law theory considered all legal principles to be pre-existent, all-encompassing, complete, and comprehensive; as a consequence, the judge merely found and applied the law to a dispute set before him.

The Instrumentalist challenged this view: He argued that law is, or ought to be, nascent, fragmentary, and inchoate in all manner of ways, leaving great latitude to the lawmaker to sculpt rules and orders to fit particular situations and to meet changing times. As in most ideological altercations, inept phrases and muddled values inhibited the Formalist/Instrumentalist combat. The fundamental soundness of the common law lay in its resistance to prior restraint and in its allegiance to a belief in an overriding natural law to which all positive law ought to conform in order to achieve the best possible (but not perfect) result. In truth, the principles "found" and applied by the King's Bench, the Court of Common Pleas, and later, in the commercial Law Merchant, reflected emerging principles necessary to a free but orderly society.

Few articulate defenders of natural law would assert that all juridical principles for all time are written down in a code-book, wherein the clever judge can turn to just the right page and find his solution. Rather, certain rules of order and causality apply to human action, just as precisely as the physical rules of gravity and thermal dynamics govern the corporeal universe; adherence to these rules of human action in resolving disputes—as nearly as any fallible being can follow precise principles—will, on the whole, produce the most harmonious out-

"Mankind is neither perfect nor perfectible; we are *individuals* capable of improvement, but the best of us always fall short of the standard."

come. The misplaced Instrumentalist derision replaced a relative certainty and a societal open texture with an unhappy formless formalism, where prediction becomes the exception, not the rule, and all of us reside at the whim of today's lawgiver.

One should not lay sole responsibility for the deterioration of legal certainty at the Instrumentalist door. Nor should one indulge in the supposition that a perfect predictability flourished in, say, the eighteenth or nineteenth centuries, only to be obliterated in a recent *coup d'état*. The seeds of Continental-style staleness flourished, to a greater or lesser extent, throughout our juridical history, and the ultimate culprit may well be an aspect of human nature to which the Instrumentalists pandered.[4] After all, while man craves predictability, he likewise displays traits of envy, arrogance, and tyranny which, plied with a false assurance of certitude, guarantee his downfall.

Those who slight the Socratic dictum ("I know not; yet, I know that I know not.") presume to assess causality accurately and events comprehensively, and to practice perfect morality. Despite their affectation of correctness, they misapprehend the nature of man and the order of his universe; therefore, they necessarily come a cropper.

Mankind is neither perfect nor perfectible; we are *individuals* capable of improvement, but the best of us always fall short of the standard. One dimension of our finiteness appears in our very inability to observe, relate, analyze, and effect events and our own actions in perfect fashion. The result we achieve often is not the result we will. We predict poorly. We comprehend history selectively and imperfectly. We decipher the ineluctable moral order and natural law of our existence in a substandard manner. Thus, we may crave juridical certainty but our fallible nature impedes us from perfect achievement and our whimsical cockiness warrants that perverse and unintended repercussions will occur. Those who seek predictability at the expense of personal liberty end up enslaved to the feeblest of minds and the most inferior mode of behavior.

V. A Demonstrable and Pervasive Deterioration

The dubious may seek proof that legal predictability is declining. Evidence abounds. The loss of certainty pervades every jural nook and cranny. A few select examples will demonstrate the point.

First, consider the law of contracts, that body of rules and orders which concerns the enforcement of promissory obligations. Perhaps in the dim and distant common law past all promises uttered were subject to strict enforcement: After all, the literalists of pre-Norman times burned fallen trees and slaughtered cattle if these inanimate objects or animals caused a human death. In any event, the Chancellor soon ameliorated the harshness of strict enforcement where, e.g., promises were induced by fraud, duress, or overreaching. Certainly, one ought not be held bound to perform an act which is the product of compulsion or deceit.

The history of the common law of promissory obligations makes one point patent: The law has slowly but surely evolved to an ameliorative stance wherein a promisor whose expectations are thwarted or whose forecast is flawed stands a likelihood of relief from his obligations, in whole or in part, at the expense of a promisee who forecasts more correctly and who now experiences punishment (in the form of *his* thwarted expectations) for accuracy. The Chancellor's Romanist/Continental influence provided the seed of many of these doctrinal devices—e.g., unilateral or mutual mistake, impossibility, commercial frustration—and modern legislators have carried on the tradition, e.g., the doctrine of commercial unreasonableness and other "public policy" pretenses. The result: Parties to a contract do not know if, and to what extent, the courts will enforce their voluntary bargain.

"The predictable past has become the uncertain present, particularly with regard to the employment and enjoyment of real property."

Crumbling certainty damns the ethical promisor to an uneasy reliance; it permits the less scrupulous to enter silly deals with the glib assumption that, if all else fails, the legal system will bail him out. Consequently, parties make less efficient use of time, energy, ideas, and materials, and employ limited resources less carefully. In Japan, commercial transactions are never really "final" in the Anglo-American sense; solemnly written contracts are constantly "renegotiated" as times, conditions, and knowledge advance; the American scene more and more resembles its Oriental counterpart in this regard.[5]

Second, the law of real property affords additional proof. Over the centuries, real property rules and orders concentrated upon the law of titles and the devolution and transfer of land, with little or no heed paid to the *use* of property. While all titles emanated from the sovereign in jural folklore, the owner assumed that he could use his land as he saw fit. If, in some rare instance, his use of realty harmed a neighbor (e.g., escaping waters or wild beasts or the like), the law courts provided a forum and a recourse whereby a judge and jury could sort out the problem without any broad impediments of prior restraint. In the area of common law concentration—titles and transfer—a few fairly well-defined and formal rules developed over time, providing a known and certain framework for the maintenance and devolution of the principal form of wealth in Medieval England and, indeed, in Colonial and post-Revolutionary America.

The predictable past has become the uncertain present, particularly with regard to the employment and enjoyment of real property. Sovereign ownership of all land constituted a noxious and unnecessary fiction; nonetheless, in most instances until recently, indulgence in this fictive conjecture brought forth precious little practical harm: The laws of nuisance, negligence, and ultrahazardous activity, while containing an embryo capable of destroying the moral private property order, were reined in by judicious judges and common sense, leaving an owner in "fee simple absolute"[6] relatively unhindered as he sought the best use of his land in his subjective sight.[7]

Today, one cares little about titles, transfers, and competing private ownership rights.[8] Instead, the landowner fears the shifting sands of *public* claims upon his private real property, by virtue of land use regulation, direct condemnation for all manner of newly minted "public purposes," zoning rules and restrictions, inverse condemnation, and a covey of their legal siblings. Even more vexing is the fact that a landowner may buy real property for use in a particular manner and for a specific purpose lawful at the time of purchase, invest substantial sums in planning and improvements, only to discover to his horror and detriment that some public (busy)body with neither investment nor good sense (nor "right" in any acceptable sense of the word) has declared that the owner's specific piece of property may not be used for his desired purpose and, sometimes, for *no* reasonable purpose whatsoever.

Terminology makes no difference: In various jurisdictions the effective body may be known as a county commission, a city council, a land development bureau, a community planning organization, a neighborhood association, a design review committee, or one of myriad other designations. The end result does not vary: unpredictable and devastating interference with private property rights, underlain by the type of legal uncertainty that breeds frustration and political fixes.

Third, a review of the law of employment relations reveals additional stark uncertainty. The market flourished and all participants prospered precisely because entrepreneurs remained at liberty to deploy labor and capital in rapid response to the changing demands of the consumer. Planning resulted from voluntary action imposed upon individual assessment and analysis; those who forecast most accurately gained

the greatest success, since they were the creators and suppliers of the most desired goods, services, and ideas. Contract, not coercion, regulated the market for labor as well as the supply of capital and the sale of products. In order to redeploy swiftly in response to market command, employers and employees often eschewed restrictive or lengthy workplace contracts: The dissatisfied workman could pull up stakes at will, just as the owner or the manager could sever the employment relationship at the end of its term.

Today, the law has skewed the workplace relationship in both an unfair[9] and an unpredictable fashion. Rules proscribing all manner of discrimination and discharge, even in the face of contrary voluntary contractual bargains, impose an unpredictability beyond measure upon the market. Some contend that American labor has priced the United States out of world markets; perhaps so, but more saliently, fewer and fewer enterprising and innovative entrepreneurs display any willingness to assume risks in an arena fraught with wholly unprecedented snares. For example, once an employee enters into a work relationship, the employer may be legally bound to feed, house, insure, and support him for the rest of his days, no matter how clumsy or inept, or how dangerous and distasteful, or how unproductive or hindering he may become. The "right to a (or this) job" slogan is fast becoming a political and economic reality.

Moreover, the employer's choice in the initial hiring process recedes almost as rapidly. George Roche described a "balancing act"[10] in academia a short time past; legislators and jurists have brought their act to the once-private market. In many jurisdictions and endeavors, the purchasers of services (owner, employer, manager) may not choose the best and the brightest: The invasive state tells him whom he shall employ and under what terms and circumstances—perhaps for a lifetime.

Government edicts do not consider quality, or the reciprocal right of the buyer of labor to his contractual rights: Instead, these norms look to a fictive balance of singular factors, e.g., age, race, religion, gender, sexuality, political persuasion, and the like. Given the expanding universe of "employee rights" in the areas of discrimination, discharge, work conditions, and benefits, to name but a few, no one can predict the cost of an enterprise with any assurance. One sure result: withdrawal of capital (goods, innovation, incentive) from the labor-intensive sector of the market, or a transfer from the capital market to the consumptive process entirely. Such market dislocations ultimately harm all participants; oddly enough, the greatest harm visits the very "classes" sought to be protected, aided, or encouraged.

Examination of every crack and crevice in the juridical structure reveals the rot of an enveloping unpredictability. Successive Congresses and legislatures create and tinker with ever-more-complicated rules and regulations, creating ever-changing codified "rights" of action and correlative prohibitions in verdant fields long void of coercive control. Legislation governing "hazardous waste" and other "environmental" conditions and uses, the trade and transfer of securities, the entry into any number of professions and enterprises, and all manner of business practices and combinations illustrates the point. The proliferation of revenue laws, especially in the disguise of "tax reform" producing a volume equivalent in size to the Manhattan Telephone Directory, further complicates the life of the ordinary citizen. The quantum extensions of liability in the several commonplace fields of tort or civil wrongs perplex the employer, producer, and national creative genius and increase litigation to the point of critical mass.[11] Substitution of wavering and often whimsical orders for known principles of choice-of-law where the rules of two or more jurisdictions come into real or apparent conflict[12] further befuddle one who tries to plan his life with any measure of good sense and foresight. Even the rules of evidence and proof shift subtly, unsettling the litigant who founded his case or defense upon the once-predictable past.

VI. Legal Unpredictability: Cause and Effect

Earlier sections of this essay have identified several causes of the developing uncertainty which plagues the United States. The pre-eminent causal factors merit reiteration.

First, we have gradually but inexorably strayed from our common law roots. We have adopted the most inefficacious features of the Continental system—codes of prior restraint, invasive bureaucracies, mandate states—concurrent with a loss of the refuge of natural individual rights. Thus, we have discarded a belief both in the natural rights of each individual and in a natural universal law against which all positive law ought to be measured. As we blithely ignore our tradition, our conditions more and more resemble those unpleasant and unproductive hovels and multitudes from whence our ancestors escaped.

Second, the specific aspect of this first and overriding reason resides in our finite human nature. It is all very well to blame the Instrumentalists, but charlatans have seduced men and women for countless centuries: Unfortunately, the ideological brigand appeals to the fallible and sinister attribute in each of us.We do crave certainty— a secure and pleasant life where all of our choices produce desirable and fulfilling results. The statist panders to our inherent deficiencies by sweetly assuring us that perfect certainty and absolute predictability is possible, if only we cede the power to plan and regulate to the all-wise codifier. Walt Kelly's Pogo wisely announced "we have met the enemy, and they is us"; few twentieth-century sages have uttered any greater truth.

One would be remiss to ignore a third causal factor, bred by the general and specific features set forth: Unpredictability breeds further unpredictability as ensuing legislators, jurists, and administrators attempt to right patent wrongs created by the faulty constraints concocted by their predecessors. When planning is consigned to the political process, the bad judgments of the lower level creatures who occupy the seats of power become magnified and encrusted upon a society and an economy which ought to be mobile and reactive to the changing desires and the improving fund of knowledge of its inhabitants. Few of us readily admit error or failure; the legislator who creates a flawed program partakes of this human trait; hence, legislators tend to make similar and increasingly foolish choices as the world they try to manage unravels. Last year's assembly could not bind the present batch of lawmakers;[13] as a result, the content of the law and the rules of procedure vary, often drastically, leaving a confused and frustrated citizenry in its wake.

"Creative, innovative, and adventurous actions spice life and lift the individual from the doldrums, at the same time occasioning the material and mental wealth of the world."

In like fashion, this paper has elucidated some of the many adverse effects of increased uncertainty in the legal fabric. Again, a summary may place the issue in focus.

In the first place, mankind encounters less difficulty in dealing with the vicissitudes of the natural order than it does with the amorphous mass created by unpredictable human beings. Man must plan and attempt to predict; since he lives in a regular, not random, world, and since he possesses the equipment and acuity to grasp relationships, he enjoys the ability to adapt and adjust to the natural order, albeit imperfectly. By virtue of the complex matrix created when fallible men attempt to order human life and action, the world becomes more random and human endeavor becomes less predictable.

In the second place, economic success depends upon accurate prediction. Since all value is subjective, the successful producer creates and distributes the goods, services, and ideas most desired in the marketplace. Satisfaction of consumer demand requires the supplier to assess those desires, an assessment which requires certainty and regularity in order to avoid mere fortuity. Thus, to the extent that the law renders the legal or permissible results of human activity uncertain, economic efficiency declines into misapplication of scarce resources to satisfy nonexistent or less pressing human wants.

In the third place, unnecessary interference with human activity and needless uncertainty creates significant human unhappiness and anxiety. Creative, innovative, and adventurous ac-

tions spice life and lift the individual from the doldrums, at the same time occasioning the material and mental wealth of the world. Useless dampers on such creative action not only impede personal and societal growth but also cause that mold of frustration which breeds in unnatural cultures. Litigiousness, instability, incivility, shoddiness, sharp practice, dishonesty, and their unpleasant companions become natural sojourners in the mandate state.

VII. A Plea for a Return to the Common Law Tradition

Mankind seeks the holy grail of a predictable world. As with the Crusaders' quest, a perfect solution eludes us. Nonetheless, we ought not give up this grand enterprise as futile; rather, we ought to adjust our legal system so as to permit each of us to seek this destiny and, to the extent of our paltry powers, to achieve it.

I plead not for our return to halcyon days of yore, to a Golden Age achieved and lost. Neither Golden Age nor shining city on the hill ever existed, save in our deepest dreams. Nevertheless, our English forebears understood the rudiments of a legal system which, if properly comprehended and carefully shielded from the dark improprieties of men, could once again serve as the jural landscape for a free, productive, and orderly society. That system—the common law tradition, founded upon a recognition that natural rights inhere in each of us, that all positive law ought to relate consistently to the natural order of things, that no fallible lawgiver ought to be cloaked with a codifying power of prior restraint, that a community system of justice exceeds professional dispute resolution in merit and fairness—proved worthy in the past. In its heyday, the common law provided the foundation for the most exciting and beneficial creativity in recorded history; it also coincided with the most mighty political revolution of all time, when these fragile states in a new world broke away from the barriers of the dull and tasteless past, from a system where tyrants sought to impose absolute certainty and could only achieve stale nonsense, and created a new legal system of freedom resting upon the finest attributes of the past.

The choice is clear: recapture the dream of a free and orderly society governed by a common system of law restricted to its proper bounds, or sink in the mire which continues to impoverish the vast majority of human beings in this world. □

1. For a further analysis of the faults of prior restraint, see Ridgway K. Foley, Jr., "Prior Restraint," 31 *Freeman* (No. 10) 609-614 (October, 1981).
2. Of necessity, this commentary upon the Instrumentalist Revolution is cursory. The subject deserves a deeper treatment; it is not relevant to the more limited point of this essay.
3. For an exploration into the labyrinth of modernism in the choice-of-law milieu, see Ridgway K. Foley, Jr., "Fragmentation in the Conflict of Laws," 47 *Or. L. Rev.* 377-389 (June 1968).
4. A respectable body of thought purveys the wisdom that decision-makers follow the robes, the scholars, and the communicators of the preceding era. In such an analysis, the revolutionary seeks to put forth his ideas in such a form so as to influence the clergy, the press and publishing houses, the wire and visual communications industry, the teachers, the scholars, the writers, and the judiciary. It would serve no useful purpose to deflect this paper from its intended course so as to consider this subordinate proposition. Nonetheless, in passing, I challenge both its veracity and utility, and suggest that ingrained human traits may not be so easily maneuvered or eradicated.
5. Sports fans and movie buffs will notice the constant "renegotiation" of agreements by players, coaches, managers, and the like. This unfortunate phenomenon extends well beyond the habitat of the athlete and the starlet.
6. This is the legal signification of the greatest "bundle of rights" one could own in real property in the common law system.
7. The state power of eminent domain also posed a threat to absolute ownership. In the United States, the Fifth Amendment guarantees of just compensation and a taking for a public use, coupled with the concept of a limited government, provided considerable protection to the private owner.
8. But, consider the unpredictability of the modern law of creditors' rights, where legislators protect favored classes of debtors at whim and will.
9. This essay delves into the decline of certainty; it remains for another day to discuss the imbalance and deleterious effects created in the marketplace by, e.g., Employer Liability Laws, Workers' Compensation Acts, mandatory unionism and the closed shop, affirmative action, and like programs.
10. George Charles Roche III, *The Balancing Act* (La Salle, Illinois: Open Court, 1974).
11. See Ridgway K. Foley, Jr., "The Liability Crisis," 37 *Freeman* (No. 1) 12-27 (January 1987).
12. Note 3, *op. cit.*
13. The Founding Fathers created a United States governed by a written Constitution, designed to eliminate whims of politicians and winds of change. Today, the constitutional limits upon governmental action are greatly attenuated; indeed, the deterioration of predictability seeps into the interstices of our governing document, as individual rights once certain become quite ephemeral and dubious.

Who Is an American?

by Richard R. Mayer

As Americans we are often un-American when it comes to illegal aliens.

The word "illegal" connotes something contrary to the law; yet what more clearly defines our law than those unalienable rights spelled out in the Declaration of Independence or what better describes our land than its heritage as a haven for those wishing to better themselves? Can we logically describe as "alien" those who seek freedom, opportunity, and equality before the law?

America is a unique concept. It is a land whose people are defined not in terms of nationality but of outlook. It is what one believes that makes an American, not skin color, religion, or language.

An American is described by his beliefs, his adherence to certain clear principles not of religion but of religious freedom, not of status but of equality of treatment, not of privilege but of opportunity. By this measure there are many true Americans who do not reside here, and others who vegetate here but are not truly Americans.

There is concern that those who come to this land may take jobs from local residents, secure false social security cards, passports, and drivers' licenses, or go on welfare. But are such regimentation and programs really the American heritage? And is beating someone out of a job by being more willing and competitive really un-American? Such objections come from those who have obtained privileged or protected positions through licensing, certification, seniority, or monopolization and who are not willing to compete in a free and open market.

Do I, because I was born here, have greater claim than one who has made the conscious choice to come to the United States? Do I through mere chance and by none of my own doing have a greater claim to being an American than he who has made the effort?

I think not. I only am an American by being an American, by making that choice daily in my life. And the refugee who makes that choice is also a true American, as much as I—a brother of the spirit, as Americanism is a matter of the spirit. He has the right to live, to provide for himself, and to care for his family, without certificate of occupancy or let from petty official or regulatory agency.

Through our churches and legislatures, we dole out billions of dollars in foreign aid—anything to keep the natives happy (and away from our shores). We charitably give to others, so long as they'll stay where they "belong." But we will not grant them the right to practice Americanism, claiming this as a privilege for those who got here first. This isn't very American. □

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Tear Down This Wall

by Russell Shannon

Last June, after his conference at Venice with the leaders of Japan, Canada, and Western Europe, President Reagan made a brief but significant visit to Berlin. There, in front of the Brandenburg Gate, he issued a striking and much-publicized challenge to the Soviet leader, Mikhail Gorbachev.

The Berlin Wall has stood for two and one-half decades as a symbol of repression by both the East European countries and the Soviet Union. Driven to digging tunnels and making other desperate attempts, people held behind the wall have sought to break through to gain the freedom and opportunities enjoyed in the West. In the process, some have perished.

The border between Eastern and Western Europe has not always been sealed. Now, at a time when the Soviet leader is preaching a policy of "glasnost" (openness), President Reagan urged him to take a dramatic step beyond talk to action. As a sign that he really means what he says about expanding freedom, President Reagan urged:

"Mr. Gorbachev, tear down this wall."

Yet less than one month after the President's proclamation, a terrifying event revealed that Soviet Russia and its satellites have no monopoly on border problems. Not far from El Paso, Texas, a railroad car was opened to disclose the bodies of 18 Mexicans who had perished in a desperate attempt to cross the Mexican border into the United States.

The border between Mexico and the U.S. has not always been sealed. Until about a century ago, we welcomed people from other lands. No walls had been erected and so no one stood guard at our gates to check entry visas. Immigrants came in great numbers, some escaping political tyranny and religious repression, others responding to the promise of economic opportunity.

Indeed, according to Oxford University professor John Gray, in the century prior to World War I, not only in the United States but throughout Europe, "Everyone believed that free migration promoted prosperity. Statesmen took for granted that the freedom to travel was part of the market economy." Classical economists argued that, "Just as tariffs and quotas resulted only in dislocating the world market and decreasing economic welfare, so too immigration controls resulted in economic stagnation and the waste of human resources." (*The Wall Street Journal,* June 1, 1983)

Yet, toward the end of the last century, attitudes changed. We began to impose restrictions, first limiting the entry of Orientals, then others. By now we have a rather rigid system designed to control both the numbers and types of people entering the country. Although legislation passed by Congress in 1986 granted amnesty to many who were living here illegally, it also imposed new constraints on employers in an effort to make further immigration less attractive.

During the summer of 1987, numerous reports from the northwestern states revealed that crops of fresh fruits and vegetables were in danger of rotting for lack of labor to harvest them. Why do we deny entry to willing laborers when there is so clearly much work to be done?

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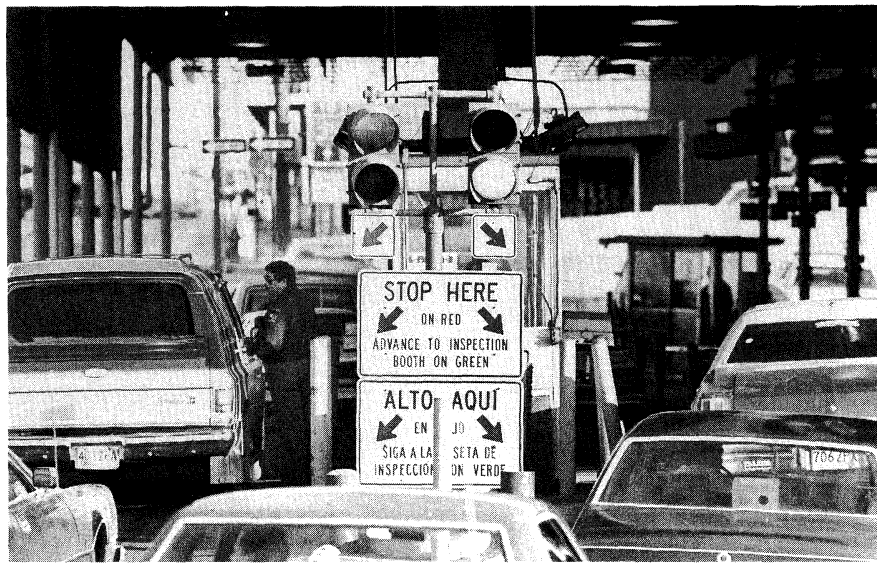

Traffic coming into Laredo, Texas from Mexico must pass through the U.S. Customs checkpoint where citizenship papers or documents for passage are presented.

Consider the following points:

• In general, immigrants do not become a burden to taxpayers. In fact, economist Julian Simon has shown that immigrants tend to be net contributors to government revenues, rather than a net drain. Often young and vigorous, they frequently pay income and social security taxes for many years, only to return to their homelands before receiving their full benefits. (*The Freeman,* January 1986)

• While it may be true that in some instances immigrants take jobs away from people who were born in the United States, there is also much evidence that Americans often don't want the jobs immigrants take.

• If working conditions for immigrants are frequently below our standards, the fact that immigrants have come here voluntarily at often great risk to themselves suggests that the opportunities they find here are at least superior to those they left at home.

• What's more, when the immigrants spend their incomes to buy food, clothing, and shelter, they provide additional jobs for people already here—an application of the famous old economic principle known as Say's Law: "Supply creates its own demand."

• In recent years, much concern has been expressed about the so-called "deindustrialization" of America. Whether the facts support these fears or not, the influx of workers willing to take jobs at low pay helps to discourage American producers from setting up shop outside our borders to cut labor costs. And for the rest of us, their work keeps the cost of products down and helps to improve our standard of living.

When people such as the Mexicans are dying in their efforts to break through the barricades and enter the U.S., just as others have died attempting to breach the barriers surrounding Eastern Europe, some extremely troubling questions demand answers: Do we have legitimate economic, moral, and political grounds for denying immigrants access to the freedoms and opportunities which we enjoy in such abundance? Can we justly deny to others what once was offered to our ancestors? Can we criticize the restrictive emigration policies of the Soviet Union and its Eastern European neighbors when we engage in restrictive immigration policies?

In view of these concerns, would it not now be most appropriate for the President to follow up his dramatic challenge in Berlin by journeying to Brownsville, Texas, and San Diego and, regarding our own unwarranted barriers to the free movement of the world's peoples, say:

"Members of Congress, tear down this wall." □

Yugoslavia: Trouble in the Halfway House

by Melvin D. Barger

What's wrong in Yugoslavia?

The news reports out of Belgrade speak of a troubled country with a stagnating economy, ruinous inflation, out-of-control foreign debt, rebellious workers, and a defiant citizenry. These problems would be ominous in any country, but they are especially so in Yugoslavia. One fear is that mounting troubles could force Yugoslavia back into the tight Soviet orbit it escaped in 1948. There are also worries of exacerbating tensions among the different national groups in the Yugoslav federation. Another fear is that Yugoslavia—whose individual countries helped create the term "Balkanize"–could simply unravel as a unified nation.

Yugoslavia's current problems are surprising because the country has been a showcase for "workers' self-management." The country's troubles must be disappointing many intellectuals in the U.S. who wanted to believe Yugoslavia had created a golden "halfway house" between capitalism and Communism. Yugoslavia was supposedly proving that there can be a "market socialism." But the dream is becoming a nightmare. Once seen as an exciting wave of the future, this hybrid socialism has fallen on hard times. And workers' self-management, the vaunted "third way," may be much of the problem.

Some believe that Yugoslavia's centuries-old religious and ethnic rivalries add to its troubles. The country also suffers from the same ills that threaten many mixed economies, including our own. Yugoslavia's major problems include excessive public spending and a system that hampers the market and distorts capital investments. Its policies encourage excessive consumption and the maintenance of inefficient industries. Its decentralization, a good thing under some conditions, has divided the country into protectionist enclaves. At the same time, despite its decentralization, Yugoslavia is also a Communist country, still infected with the flawed vision of Marx and Lenin.

One of the tragic outcomes of World War II was the Communization of Eastern Europe into what became known as the Soviet bloc. Yugoslavia, organized as a Communist state in 1945, seemed particularly menacing with its 300,000-man army and aggressive leadership under Marshal Josip Broz Tito. Though badly crippled by the war, this new Communist state appeared to be a dagger poised for future attack on its neighbors.

Break Led to New Course

Three years later, however, the shocking break between Tito and Stalin set Yugoslavia on a new course. It remained Communist in name and government, but it adopted the new economic policy which came to be called "workers' self-management." Restrictions were gradually relaxed in practice, and thousands of people left the country with the government's blessing to become guest workers in West Germany and other prospering countries. Industrial output climbed. Belgrade became a modern city with large department stores, traffic jams, and towering office buildings. Though large-scale private ownership was still

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banned, workers' self-management gave managers considerable latitude in business negotiations. Much of the country's agriculture continued to be in private hands, and a thriving private enterprise sector developed under special provisions which were variants of Communist doctrine.

Tito, a harsh Communist with amazing luck and cunning, became a Yugoslav folk hero, although not to everybody. Years after his death, he is still hated by dissident Serbians and other Yugoslavs who believe leftist influences in the British and American governments tilted support his way during World War II. This helped put Yugoslavia in the Communist camp while dooming another wartime resistance leader, General Draja Mihailovic (executed by the Communists in 1946). In the West, Tito received a consistently favorable press, and he was considered so indispensable that many feared the country would fall apart following his death. He did have the political skills to form a government representing the various Yugoslav republics, something that had been lacking in the Serbian-controlled monarchy which headed Yugoslavia following its formation in 1918. Tito died in 1980, but it's doubtful that his death had much to do with Yugoslavia's current troubles.

Workers' Self-Management

Milovan Djilas, the former Tito associate who became an outspoken critic of the Communist system, claims credit for the adoption of workers' self-management in the country. According to his recollections, he made the proposal in the spring of 1950, some months after the break with the Soviet Union. It occurred to him, he said, that Yugoslavia was now in a position to "start creating Marx's free association of producers." He explained the proposal to two other associates in the Tito circle, Boris Kidric and Edvard Kardelj. Winning support of other leaders, Djilas and Kardelj finally took to Tito the idea of introducing a workers' council bill in the parliament. They pressed him hard because they believed it was an important step, Djilas recalled. He wrote, "The most important part of our case was that this would be the beginning of a democracy, something that socialism had not yet achieved; further, it could be plainly seen by the world and the international workers' movement as a radical departure from Stalinism. Tito paced up and down, as though completely wrapped up in his own thoughts. Suddenly he stopped and explained: 'Factories belonging to the workers—something that has never yet been achieved!' A few months later, Tito explained the Workers' Self-Management Bill to the National Assembly."[1]

The main feature of Yugoslavian self-management is that of control of each enterprise by a representative body called the workers' council. The idea was not new, and in Russia it had been tried after the 1917 revolution. But in the Soviet Union, central direction of economic affairs soon replaced economic decision-making by the councils. In Yugoslavia, on the other hand, the councils were constitutionally empowered to *run* the various enterprises. Self-management was not limited to business and industry, but was also applied to service bodies such as the post office, railways, telephone service and, to a certain extent, universities and similar organizations.

There was also a provision for private enterprise if no more than five were employed in the individual activity. Most of the privately-owned and operated businesses emerged in such fields as construction, personal services, restaurants, trucking, and farming.

There were several reasons why the new plan made good politics for Tito and his group. For one thing, they continued to be Communists and, thanks to Djilas' reasoning, workers' self-management could be defended as sound Marxist doctrine. They were also disillusioned by what they called the "bureaucratic collectivism" which was choking off economic growth in the Soviet Union. Beyond that, the decentralized nature of self-management made political sense because of the severe rivalries and jealousies among the Yugoslav republics.

Not Really a Single Nation

Central control is an explosive issue in Yugoslavia in view of its ethnic and regional diversity. Yugoslavia actually means "Land of the South Slavs," but it goes back only to 1918 as a unified country and has had its present

name only since 1929.[2] The present ethnic makeup of Yugoslavia's 23 million people is 36 per cent Serbian and 20 per cent Croatian with the rest being comprised of Bosnians, Slovenians, Macedonians, Albanians, and a few other national groups. One of the persistent jokes is that Tito was the only Yugoslav, all others stubbornly retaining their ethnic identities! The fear of Serbian domination also persists in Yugoslavia, where Belgrade is the capital of Serbia as well as of the federation.

In the beginning, self-management and relaxed controls seemed to produce economic wonders in Yugoslavia. This may have led observers to think that the Yugoslavs had found the miraculous formula that would blend the dynamism of capitalism with the supposed democracy of socialism. Self-management seemed to work so well for a time that its contradictions and problems went unnoticed.

Actually, there were good reasons why Yugoslavia could expect substantial growth once the bureaucratic fetters were removed from its basic enterprises. The country had expectations of comparative advantages in many fields: mining, shipbuilding, heavy manufacturing, agricultural products, tourism, chemical fertilizers, and knitted and leather clothing. It had an energetic labor force, good seaports, and access to European trading partners who were soon to have spectacular growth.

Growth and Then Trouble

The 1960s and early 1970s seemed to be bright years for Yugoslavia. The country's exports surged to exceed $10 billion, two-thirds of this amount to countries outside the Communist bloc. Many of Yugoslavia's industries seemed highly competitive in world markets, and there were even astonishing reports that efficient Yugoslav shipbuilders wrested contracts away from the Japanese. Visiting a construction equipment manufacturing firm in the U.S., one might meet teams of earnest, friendly Yugoslavs who had come to study new equipment methods. And since Yugoslavia itself is a tourist's paradise, thousands of visitors from the West came to enjoy the country's beaches and mountains.

All this seeming prosperity masked some serious problems. For one thing, Yugoslavia's debt was becoming unmanageable. Despite growth, the country could not create sufficient jobs for its own population, a main reason why the government was willing to permit 600,000 people to become guest workers in other countries. The individual enterprises also were not financing their own growth, and most of the capital spending came from money borrowed outside the country. It was also true that much productivity came from small, privately owned businesses which had to operate very discreetly in order to survive under the watchful eyes of bureaucrats who still gave allegiance to Communist doctrine.

By the 1980s, stories about Yugoslavia were beginning to include terms like "crisis" and "economic troubles." The Olympic Winter Games of 1984 focused attention on Yugoslavia, but also "masked" the country's problems, according to *U.S. News & World Report*. This article mentioned an inflation rate of 50 per cent, public unrest leading to strikes, a crippling national debt of $19 billion (now a billion higher!), 15 per cent unemployment, and shortages of basic food supplies and even gasoline.[3] The problems continue to intensify.

Usus Fructus

Some observers attribute Yugoslavia's troubles to "high living" and the indifference of workers. It would be more helpful to study the system—and particularly "workers' self-management," since it controls the performance of the major enterprises. It is becoming painfully clear that self-management looks good only in comparison with harsh centralist economies. In competition with privately owned enterprises in the world marketplace, it is beginning to stumble badly. For one thing—despite Tito's glowing statement—it is not worker ownership. Professors Erik G. Furubotn and Svetozar Pejovich concluded that the accurate term to apply to the workers' claims in these enterprises was *usus fructus*. In American legal terminology, *usus fructus* is the right of use without ownership, as when a person is given the full use of a company automobile or some facility. They pointed out that the crucial distinction between full ownership and *usus*

fructus carries behavioral implications which were not recognized by Yugoslav economists.[4]

These "behavioral implications" were predictable. The economists believed workers in control of enterprises would attempt to gain higher incomes (for themselves) through the strategy of reinvestment in the firm. As it turned out, however, workers shunned this type of long-term thinking because there was little immediate gain to them from increasing the value of the firm's assets (they cannot buy and sell shares, as in a stock market). Their investments were channeled to things that were most likely to benefit them directly. Not surprisingly, many of these investments amount to current consumption at the expense of future productivity. When workers run the show, Barry Newman noted in *The Wall Street Journal* (March 25, 1987), the one thing they don't do is invest their profits. "They do award themselves fat raises. Then they borrow. And when debt ruins the economy, inflation tops 85% and their buying power collapses—they strike."

True "ownership" by workers would provide more incentive for real reinvestment—but this is blocked by socialist doctrine. And even if workers were more devoted to reinvestment in the enterprise, one wonders how many council groups have the competency to make shrewd and productive decisions. In U.S. companies, even highly trained managers frequently make bad capital spending choices which they regret later.

Another appalling problem in Yugoslavia is protectionism practiced by the various republics. Though decentralization is supposedly an advantage, it becomes a liability when each republic jealously guards its own turf in ways that bring about irrational and costly practices. According to a 1984 *New York Times* report, these rivalries are carried to such extremes that each republic has its own share of the railway network. A train has to switch engines every time it crosses republican borders, replacing, for example, a Slovenian engine with a Croatian one, and later with a Serbian one. Disputes over operation of the rail network were so intense, according to the article, that there was even a question whether there would be enough coal in Belgrade that winter—though coal production was up. Nothing moved while the republics argued over who would carry coal![5]

The same article also explained how politicized workers' management was keeping a nickel plant open and even expanding at a cost of millions of borrowed dollars while world nickel prices were plunging and big producers in Canada were shutting down. Similar decisions apparently have been made at other operations throughout Yugoslavia. These practices help explain why Yugoslavia has worked itself into a deep debt position which now threatens to topple the economy.

Writing in *The Wall Street Journal* (October 12, 1983), Nora Beloff explained how this had happened. "Jollied along by affluent Western banks eager to lend, and by underutilized Western industry eager to sell, Yugoslavia's ruling elite went on a spending binge, defying the advice of the country's best economists, who warned that loans on this scale could never be repaid." According to Beloff, these massive loans were raised by influential local political bosses in Yugoslavia who were keen to install big plants in their own territories. "None had the smallest concept of cost-effectiveness, nor did they consider themselves personally responsible for repayments." The loans all went for construction of large ventures like steel mills and aluminum smelters, and by the time the plants came on stream there were no funds left for working capital. So Yugoslav enterprises even depend on credit for almost all their operating costs.

Yugoslav news also gives the impression that the work pace has slowed in many industries. A report by Andrew Borowiec in *The Washington Times* (October 23, 1984) carried the ironic comment that much of a Yugoslav worker's time is spent discussing productivity. He described the situation in a shipyard employing close to 6,000 workers: "The shipyard has 672 self-management and socio-political units," Borowiec wrote. "These units hold 11,525 meetings a year for a total of 31,911 hours. In terms of production, . . . it represents one small tanker."

This management-by-committee slows decision-making as well as production. Borowiec quoted a British businessman he interviewed in a Belgrade hotel: "The whole thing is mad-

dening. These people take six months to make a decision that requires at the most one hour.''

Mises on Guild Socialism

Yugoslavia's troubles may be a surprise to many who had high hopes for workers' self-management. It's no surprise to students of free-market economics. The concept of workers' self-management is really a variant of ''guild socialism'' which Ludwig von Mises examined in his classic work, *Socialism*. One self-deception of guild socialism, Mises explained, was the belief that it could create a socialist order of society which would not endanger the freedom of the individual and would avoid all those evils of centralized socialism which the English detest as Prussianism. But it would be necessary for the state to set the aim of production and what must be done to achieve this aim, Mises noted. This central control was necessary if the system were to work at all. ''Society cannot leave it to the workers themselves in individual branches of production to determine the amount and the quality of the labour they perform and how the material means of production thereby involved shall be applied,'' Mises said. ''If the workers of a guild work less zealously or use the means of production wastefully, this is a matter which concerns not only them but the whole society. The State entrusted with the direction of production cannot therefore refrain from occupying itself with the internal affairs of the guild.''[6] Mises also doubted that the workers under guild socialism would perform efficiently under their supervisors or would know what to produce and in what amounts.

Workers' self-management in Yugoslavia seems to be a species of guild socialism, and it is apparently displaying the same contradictions and shortcomings that Mises thought would make this form of socialism unworkable. The central government in Yugoslavia has taken a number of steps to adjust to workers' self-management, but these actions only delay the solution and deepen the damage. The high double-digit inflation, for example, is the result of frantic efforts to meet impossible demands on the budget. At some point, there must be a breakdown when the currency becomes virtually worthless, when lenders will no longer be able to accept Yugoslavian debt, and when worker alienation almost paralyzes the economy.

When that happens, it's highly probable that some intellectuals will conclude that workers are too ignorant, too lazy, and too selfish to manage their own operations. The real problem with workers' self-management is more fundamental to human nature: *We all become too ignorant, too lazy, and too selfish to manage operations when we are placed in arrangements that attempt to suspend or bypass the needed constraints of the market.* None of us knows what ought to be produced when we don't have the market as a guide. Few of us work as hard as we can if we don't have incentives for doing so. And we all usually make decisions with our own interests in mind.

Is There Life After Self-Management?

What's ahead for Yugoslavia when the current system collapses or becomes unworkable? The two choices that seem obvious are a return to some highly disciplined centralist control or a bold attempt to move toward a free-market economy. The crying need, of course, is for the latter.

One of the lessons of history is that an oppressive central Communist or Fascist government does have political appeal after a system drifts into anarchy and chaos. A strong leader or party promises to restore order and direction which many people crave after a period of turmoil and uncertainty. And for a time, the new system will seem to ''work'' because it eliminates opposition and stifles dissent. The Communist clique that heads Yugoslavia could impose such control on the country, but with great difficulties in view of trends elsewhere in the Communist world. The central government of Yugoslavia also must consider possible rebellion or resistance from the republics if tight central control is re-established.

A more exciting possibility is that Yugoslavia could eventually adopt essentially capitalist forms to replace the current self-managed enterprises. The barrier to this is Communist and socialist philosophy. But it's becoming

clear that the lack of ownership status is the major defect of workers' self-management. Djilas has even suggested that workers ought to own shares in their companies. Professor Ljubo Sirc, a Slovenian who now teaches at the University of Glasgow, flatly asserts that what Yugoslavia needs is a market economy. Writing in *The Wall Street Journal* (August 10, 1983), he expressed grave doubts that any new loans or other *ad hoc* measures could solve Yugoslavia's problems without greater freedom for the self-managed enterprises.

There's also a need to break down the barriers that prevent cooperation among the various Yugoslav republics. But that will tend to happen easily and smoothly when the economic interventions are eliminated. If the railway network in Yugoslavia were under private ownership, for example, it would quickly discontinue the costly practice of switching engines when trains passed from one Yugoslav republic to another. There would be no way to keep inefficient factories in business with the elimination of subsidized borrowing through the government. Each enterprise would find its place in the world markets and survive according to its productivity and efficiency. Yugoslavian managers, now still restricted by the workers' councils, would have broader authority and accountability under a profit-driven system.

Socialist Myths

What about the dreams of "democracy in the workplace" and Marx's "free association of producers"? These are socialist myths which have led to foolish experiments and conclusions. We all benefit by being democratic in spirit and we should be free to associate with other producers. But the market will only reward us according to our abilities and it will also set the terms for our production. In a free-market economy, workers' self-management is always permissible when any group of workers wants to set up or buy a business to run themselves.

As we know from experiences here in the United States, however, worker-owned and operated enterprises have had only limited successes and have not proved either more efficient or more democratic than other businesses. There have recently been a number of employee buyouts of ailing enterprises and obsolete factories, and it's not surprising many of them continue to fail. Even under the best of conditions, it's difficult and risky to run a business. It takes expert, alert, and energetic management to keep any business profitable and on the right track. And the frequent turnover of business executives in the U.S. shows that finding good managers is a difficult task even for the most successful enterprises.

Socialism, with its outmoded ideas about class struggle, has always praised the worker and scorned the managerial class. But workers and managers should actually be partners in the production process, not adversaries. There is nothing about being a worker that makes one worthier and more virtuous, and there's nothing about being a manager that should be discreditable. Both are needed in their proper roles. Many managers, in fact, are workers who later developed good managerial skills.

In its present form, workers' self-management in Yugoslavia is bad management, bad business, and even bad politics in the long run. With full property rights in business and a free-market economy, Yugoslavia could become one of Europe's most prosperous and productive countries. Let's hope that it works out that way. □

1. Milovan Djilas, *The Imperfect Society* (New York: Harcourt, Brace & World, 1969), pp. 219-222.
2. Its name between 1918 and 1929 was "Kingdom of Serbs, Croats and Slovenes."
3. *U.S. News & World Report*, February 6, 1984, p. 37.
4. Erik G. Furubotn and Svetozar Pejovich, "Property Rights, Economic Decentralization and the Evolution of the Yugoslav Firm," *The Journal of Law and Economics*, October, 1973, pp. 275-280.
5. Michael T. Kaufman, "Decentralized Decision-Making Plagues Yugoslav Economy," *The New York Times*, October 29, 1984.
6. Ludwig von Mises, *Socialism* (New Haven: Yale University Press, 1951), p. 261.

Public Choice: The Rest of the Story

by Dwight R. Lee

Tibor Machan, in a recent article in *The Freeman* (September 1987), faulted public choice theory for ignoring the importance of ideas and ideological convictions in political behavior. Machan is correct in arguing that ideas and ideology are important influences on political decisions. He is wrong, however, in arguing that public choice theory needs to be modified to take these influences into account. The public choice model as it stands provides a coherent explanation of why, when making political choices, an individual's understanding of what is in the public interest is often more important than concern over his or her private interest, narrowly defined.

Lowering the Cost of Ideological Expression

It is true, as Machan points out, that public choice is rooted in the assumption that people are motivated by self-interest in both their market and political roles. This is admittedly a simplifying assumption, but it is the basis for the enormous analytical leverage economic theory in general, and public choice theory in particular, is able to apply to our understanding of social interaction. It should be pointed out, however, that the assumption of self-interest is not as restrictive as it is commonly made out to be.

It is undeniable that people value a wide range of things not normally thought of as economic goods and services. Among the noneconomic items that people value are their opinions and beliefs. Certainly nothing in public choice theory rules out the recognition that self-interested people may want to promote their vision of the good society.

Caution has to be exercised here, however. If we attempt to explain why people act on the basis of ideological considerations by simply putting an ideological variable in their utility function have we not, as Machan says, made "shambles of the explanatory value of the economic man model. Any . . . model that explains anything whatever . . . simply explains nothing much!" (p. 355) While this point is well taken, and does indeed indicate a risk, this risk is avoided by making sure that we go beyond simply explaining that people behave ideologically because they want to.

The public choice model does go beyond this obvious tautology by predicting that people will behave more in accordance with their ideological convictions when the cost of doing so is low than when the cost is high. This prediction is subject to rejection by empirical evidence and thus avoids Machan's methodological concern. It also forms the basis upon which public choice is able to provide an explanation for why self-interested people are more likely to make political choices on the basis of their view of the public interest than they are in making their market choices.

While individuals may place value on their personal beliefs, it does not follow that they will be prepared to make great sacrifices in order to promote those beliefs and put them into action. Some will, of course. History is full of examples of people who have endured great hardship, even death, in order to express and spread their beliefs. But most people are less dedicated and heroic. This does not mean that people will ignore their ideological preferences in the decisions they make. It does mean that people are more likely to let ideology influence their choices when making political decisions because the political process lowers the cost of ideological expression.

Consider an individual who feels that the general public would be better served by a reduction in government and is considering how

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to vote on a proposal that would increase his income but also expand government. Because of the ideological preference for the ideals of limited government, the individual will receive satisfaction from voting against the proposal.

But isn't the loss of income that will occur if the proposal is voted down a high personal price to pay for this satisfaction? The answer is "no" for the reason that no single vote is likely to determine the outcome. The probability is effectively zero that the individual's vote against the government program will break what otherwise would have been a tie vote and make the difference between the proposal's passing or losing. So it costs the individual essentially nothing to vote for his perception of the public interest (against government expansion) and against his financial interest because, with near certainty, the outcome will be the same no matter how he votes.

The costlessness of making ideological choices in the political process contrasts sharply with the cost of doing so in the marketplace. In the marketplace if an individual chooses a particular product the choice is decisive. The consumer gets the product he chooses and he gets it because he chose it. There is no hope of voting for a less preferred product for ideological reasons and still receiving the more preferred product. It is possible to express ideological preferences in the marketplace, but there is a real cost of doing so in terms of sacrificed alternatives.

We now have the basis for the public choice explanation of why ideological factors are more important in the political process than in the market process. The explanation in no way depends upon *ad hoc* assumptions that people are more concerned with the public interest when making political choices than when making market choices. People behave differently in a political setting than in a market setting, not because they bring different preferences into the two settings, but because the relative costs of alternative choices are different in the two settings.

This explains why Machan is half right and half wrong when he says: "If public servants were to become convinced that the promotion of some popular project is indeed *not a proper government activity* in the first place, then despite what they might do in circumstances which are not governed by this 'ideological' consideration, they could come to behave very differently from what public choice theory predicts." (p. 355, emphasis in original)

Machan is right to say that public servants will more likely behave differently when ideological considerations are present than when they are not. Machan is wrong, however, when he asserts that public choice fails to predict the difference in behavior. By failing to understand the public choice explanation for the importance of ideology in political decisions, Machan also fails to understand a powerful explanation as to why ideas do have consequences; in particular why ideas have political consequences.

Ideas have far-reaching consequences in all areas of human activity and they have consequences for a variety of reasons. But clearly an important reason why ideas have consequences in the political realm is provided by the public choice insight that in the political realm it costs people less to act in accordance with their ideas of what is right and proper. For this reason the battle over the proper role of government in our constitutional democracy is a crucial one. If we can once again engender a prevailing ideological commitment to the classical liberal ideal of limited government, this commitment is sure to translate into a government that is smaller and more effectively restrained than the one we have today.

Conclusion

Public choice, like any model of complex human behavior, is not the whole story. But it is more of the story than Professor Machan realizes. By subjecting the political process to rigorous analysis, public choice has been able to make a strong case for imposing strict limits on the size and scope of government. Furthermore, public choice provides a compelling explanation of why it is so important to make such a case. If the public choice understanding of government becomes generally accepted, then it will once again be possible for the people to control government instead of being controlled by government. □

Are Credit Card Interest Rates Too High?

by Jorge Amador

Interest rates on home mortgages are hovering around 10 per cent and car loans are no longer unusual at 7 per cent, but most of us are still paying annual rates of 18 per cent or more on our unpaid credit card balance. Why?

"It's a ripoff," says Elgie Holstein of the Bankcard Holders of America.[1] There is a widespread feeling that banks are somehow taking advantage of credit card users. Illinois treasurer Jerome Cosentino has withdrawn some $2.2 billion in state funds from two Illinois banks in protest over rates close to 20 per cent.[2] Alan Fox of the Consumer Federation of America blames "credit card profiteers" for what he calls "irresponsible exploitation of credit card consumers."[3]

At least five bills have been introduced in the last two Congresses to clamp down on credit card interest. Last spring a subcommittee of the House Banking Committee approved a proposal to cap rates at 8 per cent above the yield of one-year treasury securities—setting the ceiling at 13.8 per cent using the rates then in effect.[4]

Richard Kessel, executive director of the New York State Consumer Protection Board, warns that interest-rate ceilings may have to return to bring card charges in line with other rates: "The fact is that . . . deregulation is not benefiting consumers when economic conditions clearly warrant a decrease in interest rates." He adds, "Deregulation is a good idea when it promotes competition, but in this case it has not. Financial institutions and retailers have not been motivated to lower their credit card interest rates."[5]

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Competition or Oligopoly?

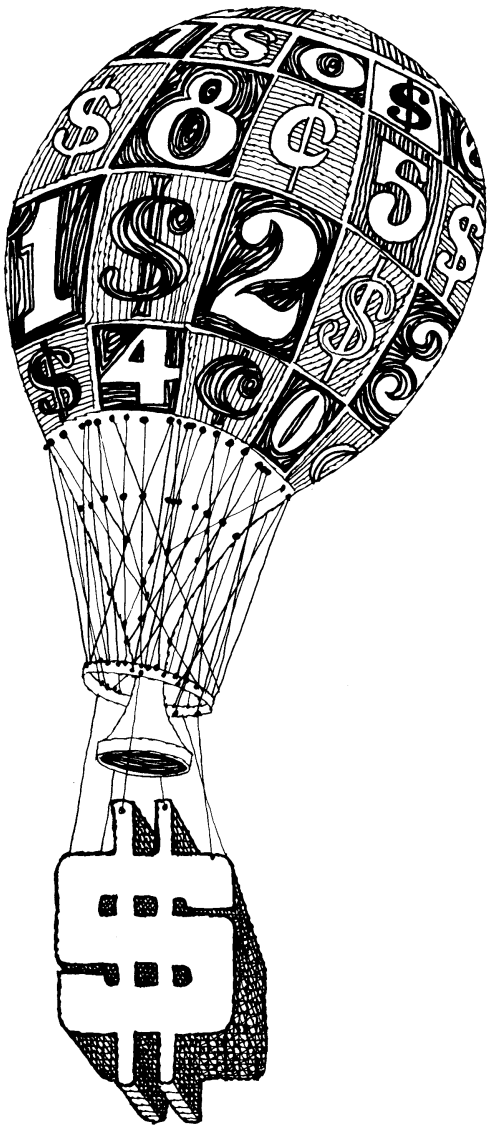
"I think the answer is self-evident: there simply is a lack of competition in the credit card business," says Tennessee Senator Jim Sasser. "A relatively small number of very large card issuers keep these rates artificially high."[6]

In a statement before the Senate Banking Subcommittee on April 21, 1987, New York Congressman Charles Schumer declared, "In every other one of those [credit financing] areas there is genuine and real competition—the free market is working. In credit cards, we have oligopoly." Schumer theorizes that the credit card market is dominated by a few large issuers who exercise "price leadership" to hold the line at a high rate.[7]

How competitive is the credit card market? In 1986, Americans held 731 million credit cards from 15,000 issuers. The largest single issuer, Sears, accounted for 11 per cent of all credit card balances outstanding at the end of 1985.[8]

Citicorp, the largest bank card provider with 9 million,[9] had less than five per cent of the 186 million bank cards issued in 1986.[10] Together the ten largest issuers accounted for less than one-fifth of the bank credit cards issued to consumers.[11]

To be sure, no consumer has access to thousands of sources of credit in his geographical



area. But credit cards are primarily a mail-order business. In principle any person could write to every issuer, apply for their cards, and shop for the best deals. Retailers may not be interested in giving cards to people who don't live near their outlets, but on the other hand some banks aggressively seek customers across the continent.

As Senator Phil Gramm of Texas observes, "I have access to the mails," and through them "I have access to credit cards. Is it not right that I have more access to more different sources of credit and general credit cards than I have access to grocery stores and to drugstores?" The consumer is limited to the grocers and drugstores in his area, but he isn't limited to the banks in his area.[12]

The rate of interest is only one of the elements of revolving credit plans that may be subject to competition among issuers. Credit card programs vary widely over such features as:

- *Annual card fees.* The fee charged for having a card ranges among issuers from none to $25 and higher. Sears offered a no-fee first year to attract applicants to its Discover card.
- *Transaction charges.* Cash advances made against the credit line (as opposed to card purchases) usually but not always incur a per-transaction fee, ranging from 50 cents to $1 to a percentage of the cash advance.
- *Length of the grace period.* The grace period or "float," the interim between the moment you charge your purchase and the moment interest begins to accrue, is typically 25 or 30 days. Some banks do not offer grace periods and charge interest on all purchases and cash advances made during the month.
- *Interest calculation method.* The grace period might begin at the time the bill is prepared; or it might start on the date a purchase is made or posted, which gives the customer less time to pay before interest begins to accrue.
- *Discounts and enhancements.* Citibank offers "Citidollars" on every purchase. These "dollars" can be traded in for discounts on merchandise bought through the issuers.

The First National Bank of Chicago offers special "First Card Checks." These notes are used like checks and serve as an emergency cash advance when a bank or electronic teller is unavailable.

Other credit card issuers have tried pre-approved credit lines, low-cost insurance, and rebates on purchases made with their cards. "Some creditors even prefer to compete with discounts on winter cruises than modest interest reductions," observes *The New York Times*.[13]

So, if card issuers are competing on all these fronts, and the market is truly so free, why aren't they competing on the basis of interest rates, too? Isn't it the case that, as Alan Fox says, "The market won't be allowed to work by those with a stake in high interest rates"? Hasn't competition failed here?[14]

There are two answers: Some are indeed competing on the basis of interest. But most won't compete on that basis because they want to make credit available to a wide audience.

Some banks do offer substantially lower interest rates. Groups such as Holstein's Bankcard Holders and Fox's Consumer Federation regularly publish lists of low-interest banks, some charging less than 12 per cent. But these banks seldom exploit their rate advantage through mass marketing. All else being equal, banks with higher rates can better afford to offer their cards to a nationwide audience. It is of little use to consumers for a bank to have low rates if they don't hear about it.

Looking at the Costs

The credit card is one of the most convenient ways to borrow money, but it is also one of the costliest ways to lend money. Whereas a home mortgage may run over $100,000 and a car loan over $10,000, the average bank card transaction is $50.[15] Even in today's automated environment, processing constitutes a higher proportion of the transaction costs the smaller the transaction is.

"In fact," says Jerry Craft of the American Bankers Association, "administrative costs can account for more than half of the rate charged on bank credit cards. By comparison, only a little more than 10 per cent of the average mortgage rate can be attributed to administrative costs."[16]

The bigger the loan, the bigger the role that financing costs play in the rate. Financing cost is the price the bank pays to obtain the funds it lends to credit card users. "During the period 1974 through 1984," said Federal Reserve Governor Martha Seger to the House Subcommittee on Consumer Affairs, "financing costs averaged only about three-tenths of total expenses, before taxes, for the credit card function at participating medium- and large-sized banks that issue credit cards. By comparison, financing costs at banks in the same size classes accounted for more than three-quarters of total costs of the commercial lending functions, and for nearly nine-tenths of total costs of mortgage lending."[17] Hence the greater tendency of such large loans to come down with the prime rate.

Craft breaks down the costs incorporated into the prevailing credit card rate roughly as follows: 7 per cent for financing; "up to 5 per cent" for administrative costs, including fraud; and 3 per cent for losses from customers who don't pay their bills. He estimates the opportunity cost of the grace period at an additional 3 per cent. For these reasons Craft prefers to call the credit card rate a "service" rate rather than an interest rate.[18]

Plastic money historically has been among the banks' least profitable financial instruments. In the January 1987 *Federal Reserve Bulletin,* Glenn B. Canner and James T. Fergus show that profits on bank cards trailed those for commercial loans, installment plans, and real estate mortgages in six of the 14 years from 1972 to 1985. Pre-tax net earnings in the period averaged 1.9 per cent a year for credit cards, 2.3 per cent for mortgages, 2.4 per cent for consumer installment debt, and 2.8 per cent for commercial and other loans.[19]

Cards yielded the highest average net returns in only four of the 14 years. Two of these were 1984 and 1985, when profits rose to 3.4 and 4.0 per cent.[20] "But those margins attracted competition, and higher default rates and battles for market share have already lowered profits to a 3 per cent return on assets," cautioned *Business Week* in 1986.[21]

Canner and Fergus add that cards issued by department stores and other retailers have "consistently operated at a loss" through the years.[22] Merchants find store cards useful because they profit from the additional sales that the cards facilitate, not from the interest they earn on account balances.[23]

Given the record, Canner and Fergus conclude, "it seems unlikely that card issuers could absorb significant reductions in revenue from finance charges over the long term merely by accepting lower profits."[24] Lowering ceilings on interest rates would threaten credit-card plans and customers, not just trim fat.

Dealing with Rate Caps

When faced with interest ceilings, card issuers have to adopt strategies no more pleasant than the current interest rates. Banks were squeezed in 1979-81 when the cost of obtaining

funds rose above the interest they were allowed to charge. According to Seger, "when market costs of funds rose sharply between 1979 and 1981 while credit card rates were restrained by the ceilings, marginal and even average net returns on credit card receivables turned negative."[25]

In response, "Some banks are considering charging card holders a yearly fee to help bring profits back up," said one 1980 report on the credit crunch.[26] Today, annual fees are the norm.

The grace period might be shortened or eliminated. Soon after the Connecticut legislature lowered the credit card rate ceiling from 18 per cent to 15 per cent in June 1986, some banks dropped grace periods. As one bank director put it, "We make money because we charge interest from the date of purchase."[27]

"You told us you're looking for a credit card without a high interest rate. And we hear you!" reads a print ad for a major Pennsylvania bank's Visa card. The chart advertises a "14.0 per cent annual percentage rate." But the grace period on new purchases, says the chart, is "none." Users must pay interest on every purchase whether or not they pay off their whole balance at the end of each month.

Tracy Mullin of the National Retail Merchants Association stresses that "retailers' *effective* rates are well below the *nominal Annual Percentage Rate* that is disclosed. This is because a substantial portion of retail customers pay their bill in full each month, resulting in no finance charge revenue on such accounts" (emphasis in original).[28]

According to Canner and Fergus, the proportion of customers who pay their bills fully each month is 47 per cent,[29] and 48 per cent of users with less than $10,000 in annual family income.[30] Dropping grace periods would effectively increase the cost of credit cards to the millions of customers who treat their plastic as a convenient substitute for cash, clearing their balances at the end of the month.

Card issuers charge merchants a fee for every purchase made on their cards. This "merchant discount" ranges from 2 to 8 per cent,[31] though on small transactions the fee may be a fixed amount. The discount could be raised in response to a rate ceiling, and merchants might raise the prices on their goods to compensate.

Retailers with their own card plans might also raise their prices to make up the loss on such plans. Consider the case of Arkansas, a state with some of the toughest legislation against "usury" and hence some of the lowest credit card rates. Canner and Fergus report that major appliances, which are usually bought at credit, "were found to cost 3 to 8 per cent more in Arkansas—nearly 5 per cent more on average—than in neighboring states."[32]

Interest Rates and Usury Laws: A Brief History

A legacy of the colonial period, tight lids on interest were common among the states until very recently. As late as the mid-1950s "the legal rate was 4 per cent in one state, 5 per cent in five states, 6 per cent in forty states, and 7 per cent in four states," writes Sidney Homer in *A History of Interest Rates*. "A majority still clung formally to the 6 per cent tradition of the Stuart kings."[33]

These usury statutes "did not contemplate modern consumer credit. Under them there was often no legitimate capital available for small personal loans to urban workers," writes Homer.[34]

"In general the loans they demanded were too small and the risk was too great for them to be supplied profitably at rates permitted under the usury laws," observes another analyst. "Lenders thus had to operate illegally if they were to engage profitably in a consumer cash loan business at all."[35]

"Loan sharks" supplied the common man with easy credit at exorbitant interest. Their importance declined when state governments began to permit lenders to charge for small loans at rates higher than the traditional ceilings.[36]

Credit cards followed a similar, if less extreme, pattern of popularization. National plans began two decades ago "as an exclusive service for special customers whose ability to repay their debt was beyond question."[37] As rate ceilings crept up to about 18 per cent, middle- and lower-income earners found it easier to get credit.

When credit card yields were last squeezed in 1979-81, millions of late payers and delinquent accounts were dropped nationwide.[38] Eligibility standards for new applicants were tightened. Some banks refused new credit card accounts,[39] and others canceled their card plans altogether.[40] In response, many states raised their rate ceilings up to 25 per cent, and some removed them completely.

Today, higher rates in most states permit banks to accept riskier customers. They have reacted to falling funding costs "not by reducing rates, but mainly by increasing the availability of credit cards." This "increased availability reversed the earlier curtailment of such credit that card issuers undertook" as their funding costs rose through 1981.[41]

Applicants with a spotty or limited credit record—primarily, but not exclusively, young and lower-income people—today can shop for banks in states allowing higher interest. A national rate ceiling would limit significantly their access to credit.

Simmons First National Bank of Pine Bluff, Arkansas, with a 10.5 per cent rate as of last March, is usually listed at or near the top of institutions charging low credit card interest. It makes a profit, but only by "being highly selective about whom it issues cards to, by funding the business with cheap local deposits and by taking advantage of its low overhead."[42]

A 1979 Purdue University study comparing credit card holders in Arkansas, Illinois, Louisiana, and Wisconsin found that fewer Arkansans at all levels of education held bank cards than did comparable people in the states with looser rate rules.[43] Surveys indicated that "a higher proportion of consumers reported being rejected for consumer credit compared with consumers residing in states with less restrictive rate ceilings."[44]

While 10 per cent of families with annual incomes of less than $6000 in the other states held bank credit cards, five per cent—half as many—such families in Arkansas had the cards. Ten per cent of Arkansas households headed by a person under age 25 had bank cards, compared to 19 per cent of such households in Illinois, Louisiana, and Wisconsin. Overall, 39 per cent of families in the other states had bank cards, but only 29 per cent of Arkansas families did.[45]

Arkansans who can't get credit in their state have the option to shop for cards with higher rates from banks located outside the state. Because a national rate cap would eliminate that alternative, we could expect its effects on credit availability to be more severe than Arkansas' controls have been for Arkansans.

Populism or Elitism?

Interest rate regulation has a certain populist appeal. Politicians and consumer activists have denounced "usurers" and money-lenders, and made careers out of standing for the "little guy" against the big, bad banks.

Now we have an opposite class-based excuse for controlling interest rates. Said Elgie Holstein about the effect of credit card defaults on card rates: "I think here much of the fault lies with the banks themselves, and not even all the banks, but simply those large interstate institutions that . . . mass-market credit cards. . . . I think if we were simply to look at their loss rates, what you'd find is that the banks that are mass-marketing cards indiscriminately are experiencing the highest loss rates."[46]

Senator Jim Sasser concurred:

> I don't believe that all consumers ought to be advanced credit. I think that credit ought to be advanced to those who are credit-worthy. It appears to me that under the present credit card system, those of us who pay our bills are being asked to also pay the bills of the deadbeats who don't want to pay. . . . [I]f we advanced credit to those who are credit-worthy . . . the rates could come down very substantially, and the banks who advance the credit could make a reasonable profit, which they're certainly entitled to.[47]

"You're exactly right," Holstein told Sasser. "There is some economic level below which consumers not only should not have credit, but are poorly served if they are given credit."[48]

Elitism, too, rationalizes forcing card rates down. We responsible, well-to-do gentlemen ought to enjoy the benefits of credit; let the

"Abolish" Interest?

The cyclical fluctuations of business are not an occurrence originating in the sphere of the unhampered market, but a product of government interference with business conditions designed to lower the rate of interest below the height at which the free market would have fixed it.

Therefore there cannot be any question of abolishing interest by any institutions, laws or devices of bank manipulation. He who wants to "abolish" interest will have to induce people to value an apple available in a hundred years no less than a present apple. What can be abolished by laws and decrees is merely the right of the capitalists to receive interest. But such decrees would bring about capital consumption and would very soon throw mankind back into the original state of natural poverty.

—LUDWIG VON MISES, *Human Action*

masses make do without it, as in the good old days. Since the banks aren't cutting off the rabble in order to lower our rates, we'll do it for them.

And indeed it is true that default rates on credit card accounts are climbing. A U.S. Chamber of Commerce economist reports that "Bank card industry losses since 1970 have fluctuated between 2 per cent and 4 per cent of credit outstanding. At the end of 1985 they were between 3 and 3.5 per cent; and credit card defaults in 1986 are expected to rise to 4.2 per cent of charges outstanding."[49] Rising losses counteract the effect of falling financing costs on credit card rates.

Though we may find his attitude distasteful, Sasser's point is understandable. Why should good credit risks subsidize poor risks?

An "Optimal" Solution

While politicians, regulators, industry lobbyists, and consumer advocates wrestle over legislative proposals, the market is already resolving the dilemma, accommodating all without government prodding.

In spite of all the factors militating against lower interest rates, some banks have lowered their rates voluntarily. American Express introduced the Optima credit card last spring with a 13.5 per cent rate.

American Express's action was used by some as evidence that the marketplace "is working," that it will and does respond to consumer dissatisfaction by reducing interest rates. *Business Week* dubbed it the "Credit Card War."

"The greater consumer sensitivity to interest rates no doubt figured in Amex's plans to take a plunge into the business with a lower-rate card," cheered *The Wall Street Journal*. "Credit card interest almost certainly will come down. It will come down without rate ceilings. Nothing does it like competition."[50]

However, the Optima card is available only to those who already hold American Express charge cards. The annual fee for Optima is $15. On top of the $45 annual fee for Amex's basic "green" card, it costs $60 a year to get the Optima card.[51]

Applicants must meet more stringent requirements for American Express cards than for other cards to begin with. Indeed, this is part of the "snob" appeal of "membership" in American Express. The company isn't even offering the new card to all "Cardmembers," but only to those who have been members for at least one year and who have "solid credit histories."[52] Thus Amex is marketing Optima at a high annual fee to a select group of proven, safe credit risks.

Despite the hopes of some friends of the credit card marketplace, Optima's introduction has not led to a rate war. "Watch for small interest rate reductions on premium cards—those offering larger credit lines and requiring better credit histories," advises *Fortune*.[53]

The market "is working," but in a different

manner than its enthusiasts predicted. Amex's gambit may lead to a stratified market where lower-risk customers can borrow at lower rates and higher-risk customers can find credit at higher rates. This would eliminate Sasser's and Holstein's objections against penalizing everyone for a few deadbeats, without drying up credit for the poor and the young.

We already have witnessed steps in this direction. In addition to Optima, there is Citicorp, which has cut rates to "preferred" customers to 16.8 per cent, while the rate for others remains at 19.8. Wells Fargo "dropped its credit card rate from 20 per cent to 17 per cent, but only for customers who've had a Wells Fargo bank card for at least five years."[54]

We could, in classical populist fashion, indict the market for treating better and worse risks differently, and call for a uniformly low rate. But this policy would do a disservice precisely to the "little guy" we would be trying to help. Instead of making low-cost credit available to all, it would dry up credit to poor risks and reserve it to good risks. Market segmentation permits access to credit to people of all backgrounds while rewarding those who pay their bills.

Free-market credit card rates make possible lower prices, greater access to credit, and other conveniences. If we get mad and force the rates down, we'll bear the costs in other forms. One way or another, we must pay for our tastes. □

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A REVIEWER'S NOTEBOOK

The Birth Dearth

by John Chamberlain

Ben J. Wattenberg, a demographer by profession, did some informal polling of students in a Michigan high school in 1985 to determine their preferences in family size. What he discovered set him off on a world-wide statistical trail that has resulted in a startling book called *The Birth Dearth: What Happens When People In Free Countries Don't Have Enough Babies?* (New York: Pharos Books, 182 pp., $16.95).

The students Wattenberg queried in the Michigan school were born to mothers just after the Baby Boom had ended. The fertility rate of the mothers (2.4 children per woman) was still high enough to guarantee a population increase. But the students who responded to Wattenberg's questions projected a different story for the future. To Wattenberg's question, "How many want to have four or more children?" not a single hand went up. Only a tenth of the students' hands rose in response to the question, "How many want to have three children?" But a whole sea of hands (half of the group) indicated a two child per family preference. Thirty per cent of the students voted a one child per family choice, and a tenth wanted no children at all.

When Wattenberg worked out his arithmetic, the informal expectation data came to 1.6 children per woman, far short of the 2.1 figure for a replacement level. A small Michigan sample is hardly enough to prove a world trend or even to justify a country-wide prophecy. But Wattenberg went home from Michigan to consult the census data. He discovered that for quite some time the total fertility rate in the industrialized nations of the West has been running well below the 2.1 replacement level. Japan went below the replacement line in 1957. West Germany followed Japan in 1970. By 1980 all the major free nations were below the replacement figure.

This evidence was not enough to dispose of Stanford University's Paul Ehrlich's book, *The Population Bomb,* which frightened so many people in the 1960s. Ehrlich, relying on figures from India, Red China, and the Third World countries of Africa, believed he had brought Malthus up to date. The people in the modernized industrial nations might not be reproducing themselves, but immigration would make up the difference. There would be at least a leveling-off, at four children per family, around the world.

Not so, says Wattenberg. In the first place, the industrialized nations of western Europe and America are against unlimited immigration. Secondly, Wattenberg's figures for nations that have been at the total fertility rate of four children per family will, within foreseeable time, fall below the 2.1 level themselves.

How Wattenberg can be sure that people in the less developed countries will cease to reproduce themselves is not immediately apparent. He tells us that fertility in the Third World, though still quite high, has been falling for fifteen years. But has anyone really been able to count the population of China? If the one-child allowance in China per family were, after the current capitalist surge, to be increased to two or three, what would this mean? The AIDS death rate in Africa might compli-

cate figuring for that continent. So might a cure for AIDS.

Wattenberg is on more certain ground when he sticks to the West. He worries about what will happen when domestic markets shrink as reproduction falls and there is a general "graying" of the population. The optimists say that, with the birth dearth yielding fewer younger workers, there would be more bidding for their services. Youth unemployment would go down as wages went up. More capital would have to be invested to buy equipment to replace the higher cost of labor. The newer equipment would mean higher productivity per worker.

Wattenberg says this is a nice scenario. But the birth dearth would provide fewer buyers. There would be little call for new housing. What would happen to the jobs of people who make furnaces, air conditioners, stoves, refrigerators, electronic garage doors, and all the other things that now go into new houses? And what about the real estate brokers, the mortgage bankers, and the termite inspectors? With Yuppies growing older, they might want to buy up-scale houses. But who, asks Wattenberg, would buy their old houses? With dead people leaving empty houses, the whole problem would be compounded.

Tumultuous Times?

Wattenberg hasn't worked it out industry by industry to reach any final conclusions about the loss of markets due to a declining population. But he is sure the disappearance of markets would lead to tumultuous times. He has some remedies to offer. One would be to subsidize young couples to have more than 2.1 children per family. A $2,000 family allowance per third and fourth child might be a good lure. But the money would have to come from higher taxation or from inflation. Wattenberg has nothing to offer that would avoid these undesirables.

As an economist, Wattenberg might have considered that it is the high-tax philosophy coupled with the "safety net" provision of "entitlements" that has made it necessary for women to go into the labor market in order to keep family living standards from dropping disastrously. The average family today needs two incomes. If this could be changed, families could go back to rearing and educating more children.

Is there any likelihood that the western world is about to abandon the Welfare State philosophy? The world does learn. It might even learn how to live with a birth dearth without any great discombobulation. What happened in England after the Black Death is instructive. The need for workers in the towns in the post-Black Death years killed the feudal system and set capitalism on its course. The human race is adaptable. It is strange that Wattenberg does not mention the Black Death. He might have made something of it. □

TWO ESSAYS BY WILHELM RÖPKE: THE PROBLEM OF ECONOMIC ORDER, AND WELFARE, FREEDOM AND INFLATION

ed. by Johannes Overbeek

University Press of America, 4720 Boston Way, Lanham, MD 20706 1987 • 103 pages • $19.25 hardback, $8.50 paperback

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Reviewed by Richard M. Ebeling

Wilhelm Röpke was one of the most respected and influential German economists in Europe, both before and after the Second World War. In 1933 he delivered a blistering lecture right after Adolf Hitler became Chancellor of Germany; he warned that National Socialism meant the death of culture and humanity in his German homeland. He was given the honor of being one of the first university professors expelled by Hitler. After several years in Turkey, he finally settled in Geneva at the Graduate Institute for International Studies, where he taught until his death in the early 1960s.

During the war he wrote several books, *The Social Crisis of Our Time, Civitas Humana,* and *International Order and Economic Integration,* in which he set out the moral ideal and economic principles of the free society. These and other works of Röpke's bore fruit through their influence on those who implemented the market-oriented policies which led to the "German miracle" of the post-war era.

Two Essays by Wilhelm Röpke reprints two of the best of Röpke's shorter works. "The Problem of Economic Order" is the text of four lectures delivered at the National Bank of Egypt in 1951. In a brief space, Röpke brilliantly analyzes the alternative meanings of socialism, discusses the nature of the "economic problem," contrasts the market economy with socialism, and criticizes the premises and consequences of Keynesian inflationary policies.

But what is crucial in this essay is how Röpke views the nature of the problem. What he is interested in looking at are not the specifics of particular policy proposals. Rather, the task is to look at the economy in "fundamental terms." Those fundamental terms revolve around the question, "How shall the activities of a vast number of people in a diverse system of division of labor be coordinated so the economic prosperity of the community is assured?" The alternatives, Röpke explains, are market competition or political command. And since socialism is unworkable there is no alternative to the market economy, in which competitive prices serve two functions: to disseminate information so individuals are guided into the correct production activities, and, as income incentives, to harness self-interest to the public interest.

The essay "Welfare, Freedom and Inflation" is the text of a monograph written by Röpke in the mid-1950s. Röpke saw the establishment of the Welfare State as an historical paradox. Prescribed as a remedy to the supposed hardships and traumas of the Industrial Revolution, its implementation in the 20th century occurred at the time when the market economy had overcome its initial 19th century birth pangs. Just when the market was developing the financial wherewithal and economic situations to enable individuals to plan and finance their own welfare requirements, the State interfered and prevented the market solution.

The Welfare State was emerging as a moral and financial monstrosity, according to Röpke. Rather than fostering self-reliance and self-responsibility, society was degenerating into a circular process in which everyone tried to live at the expense of everyone else, through the agency of the State. And as this monetary merry-go-round speeded up, the burden of government expenditures multiplied.

This process always leads to inflation, said Röpke. As government spending exceeds what the populace will tolerate in the form of taxation, the State resorts to the printing press. But in the process, inflation distorts production, destroys the value of existing savings and the incentive for future saving, weakens the economic and moral link between work and reward, and opens the economy to the pressures of special interest groups as each tries to win from the inflationary environment at the expense of others.

The first decade after the Second World War was one of great pessimism for proponents of the market economy, and that pessimism is visible in Röpke's essays. But besides the clarity and soundness of Röpke's arguments, these essays stand as examples of integrity to principle and truth regardless of the apparent intellectual and political odds. □

THE FREEMAN
IDEAS ON LIBERTY

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1988
VOL. 38
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THE FREEMAN
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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Bruce M. Evans, chairman; Thomas C. Stevens, vice-chairman; Joseph E. Coberly, Jr., vice-president; Don L. Foote, secretary; Lovett C. Peters, treasurer.

The costs of Foundation projects and services are met through donations. Donations are invited in any amount. Subscriptions to *The Freeman* are available to any interested person in the United States for the asking. Single copies $1.00; 10 or more, 50 cents each. For foreign delivery, a donation of $10.00 a year is required to cover direct mailing costs.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

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PERSPECTIVE

Who Are the Poor?

When St. Paul's cathedral was rebuilt after the Great Fire of London of 1666, King Charles II visited the finished building. Upon completing his inspection, he allegedly turned to the architect and proclaimed that he found the cathedral "awful, amusing, and artificial."

The architect was delighted. In those days, the word "awful" signified what today we would call "awe-inspiring." "Amusing" and "artificial" corresponded to today's terms "amazing" and "artistic." This is a rather striking example of the usually harmless ways in which words change in meaning over the years.

Yet some changes in the meaning of words are ominous. Consider the word "poverty."

The term has always signified a significant shortfall of goods and services relative to some standard. But what standard?

The goods and services needed for bare survival? The goods and services necessary for basic health? The goods and services needed for a "tolerably comfortable and secure exis-

tence''? Over the years, poverty has been equated with a significant shortfall of goods relative to all these standards.

The latest suggested standard, however, is profoundly different from the above. Poverty today is widely understood in terms of a significant shortfall of goods relative to the goods possessed by the wealthiest members of a given society.

In this way, the notion of ''poverty'' has been linked to the concept of ''equality.'' To abolish poverty it becomes necessary to ensure that the ''gap'' between the wealth possessed by the poorest members of a society and the wealth possessed by the wealthiest members of that society does not exceed some—necessarily arbitrary—factor.

Some quite amazing conclusions derive from this definition of poverty:

- By this definition, a society in which all people were equally destitute would be a society without poverty.
- If poverty signifies a significant shortfall of goods relative to the goods possessed by the wealthiest members of a society, poverty can be claimed still to exist until complete equality of possessions is realized. All that has to be done is continually to redefine what constitutes a ''significant shortfall.''

In this way the ''poor are always with us.'' So, alas, is the veritable army of government-employed ''poverty fighters'' primarily responsible today for defining poverty!

Each conclusion, surely, is absurdly unacceptable. That says something about the definition!

—*John K. Williams*

Robbing Ourselves

Consumption by the wealthy, however conspicuous it might be, represents only the ''tip of the iceberg'' and isn't much affected by the various tax schemes whether of the ''soak-the-rich'' or ''help-the rich'' variety. Increase their taxes and the bulk of the tax will be paid from their savings—savings which ultimately provide the housing stock, factories and productive machinery which house and employ millions of citizens. (Decrease their taxes, on the other hand, and again their consumption is relatively unaffected, but savings, investment, employment all increase.) Dole the increased tax receipts from the wealthy out to nonproducers and you increase demand without increasing supplies. Prices will rise and everyone's standard of living will decline accordingly.

Only to the extent that the wealthy are first able to restore a portion of their confiscated assets (through higher profit margins in response to increased consumer demand, for example) will they begin to offer jobs, agree to higher wages for workers, and so on. The net result is that the wealth bestowed on nonproducers is derived not from one wealthy stratum of society but rather from all strata, roughly in proportion to income and wealth shares that prevailed before the attempted redistribution.

—*William T. Chidester*
Market Vantage

Pass the Hay . . . .

I strongly suspect that if Henry Ford had had to bring out his Model T in today's environment, the courts and the regulators would have stopped him. Darn thing was dangerous; why, you could break your arm cranking it. Of course, horses were dangerous, too, but as an established technology, horse transportation would have fared better in the courts and regulatory halls. . . .

We are stifled by our own do-gooders, our law courts, our bureaucrats. Today the Wright brothers could not get off the ground. Could our early railroads have passed an environmental impact or safety test? What would the unions have done to Eli Whitney's cotton gin?

—*Peter Huber, writing in the July 13, 1987 issue of* Forbes.

THE FREEMAN
IDEAS ON LIBERTY

Among the Barlows

by Victor Bobb

We called them barlows. The term was both condescending and unjust, for most of them were not really barlows. But there was enough generic similarity that the label was too useful to be abandoned.

In the beginning a *barlow* was an itinerant wino who hired on as a farm laborer and worked just long enough to save the money necessary for a good long binge. We gave them the name in recognition of their origins: Barlow's was a combination employment agency and tavern near the tracks in Spokane, and while barlows were waiting for the employment agency side of Barlow's to place them, they were generally letting the bar side of Barlow's please them.

We non-barlow farmworkers—summering college students, unambitious post-high school rural kids, and weathered old lifers—were content to refer to most of the itinerants as barlows, even when the implications of drunkenness and unreliability were unfair.

I worked with dozens of them. They were generally taciturn men, but they were willing to answer my questions, and I learned a lot about them. They were glacier-speed drifters, for the most part, men who began in the midwest and found themselves twenty or thirty or forty years later in eastern Washington. Walt was from Wisconsin, quit school at 14 to work in a pulp mill in Green Bay, spent twenty minutes in the water off Okinawa after his ship was kamikazied, and lived when I knew him in a battered and stuffy old company-supplied travel trailer moored under a line of lombardy poplars on the edge of a pasture. Jack began in Nebraska; he had a sister living in Spokane (not sixty miles away) but in the three years he had been working here he had never made it those last five dozen miles to see her. Al was originally from a wheat farm near Pierre (pronounced peer), South Dakota; a hardworking man with a family, he was several cuts above most of the others. Ernest was a pathetic one, a tall pallid man with thick brown hair brushed straight back from his forehead. He looked like a fallen Bulgarian aristocrat, and he swore that he had been a concert violinist until he had been ruined by drinking. Surely he had astonishingly long white fingers (with which he now drove a clattering Cat D-6 over twelve thousand acres of marginal scabland wheatfields). Ross was a big-bellied Missourian who couldn't figger any reason for us to be mad at them Chinamen; they 'uz just people like anybody elst. Larry was barely my senior, an ignorant veteran with a gimpy eye and an inexhaustible supply of lies and fascinating nonfacts (he was in the street-legendary car stopped going four miles per hour on the freeway while its stoned driver thought he was doing a hundred; the U.S. Air Force has captured and disassembled several flying saucers but is keeping the fact covered

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up); he drank scotch at lunch one day and fell off a ladder. To cover up he claimed a dizzy spell from a war wound and as a result I was given a work assignment which I had coveted but which my juniority had denied me. Thanks, Larry, or thanks, Glenlivet: I used the free time in that job to rough out my dissertation and to read all of Melville and Faulkner.

These men were genuinely interesting to me. I liked them, and I enjoyed working with them, talking to them, responding to their elaborately obscene pantomimes, reflecting on their experiences and their futures. As a Certified Good American and Nice Guy I recognized their contributions to the general weal: we eat because uneducated men sling hay and truck wheat and herd cattle and repair plows. It took me a while to break training and to realize something beyond the Certified Wholesome Opinion, though. But then I realized it: I was not simply more lucky than these men. I and mine were, in stark fact, more competent people.

We wince. It sounds coarse, arrogant, smug. But even though the wince springs from a laudable source, it's time to stop wincing and look with something like objectivity and unsentimentality at the things which distinguish college professors from winos.

God bless Jeffersonian democracy and its ideals. They are in large measure the springs of our cultural, economic, and political strengths and successes. But we have become conditioned by the softer edge of twentieth-century egalitarianism to forget that the Jeffersonian ideal of equality (not to mention the nobility of the yeoman barlow) is an ideal of equal beginnings, not necessarily of equal endings. And we have been beaten, culturally, into forgetting that the second part of the Jeffersonian model sees—and celebrates—the rising to the top of an aristocracy of merit and talent and energy. We need to recall some of the forgotten ideas, to recapture some of the principles which have been discarded in favor of mushy dreams, unrealistic pretenses, and wishful thinking which ignore the concrete facts of existence.

Walt was pushing sixty and had lived for forty-five years in variations on the theme of that grease-spattered and airless little cell in which I knew him fifteen years ago. I was living then in a hotel room which cost eight dollars a week; it was a clean little hole in a dying farm town. Now I'm living in a five-bedroom house which was elegant before the Kaiser abdicated; it's not in the best neighborhood in town, but the taxes are reasonable and

we like the old woodwork and the oak floors and the big trees. Walt, if he is still alive, is certainly living in some place very similar to that stuffy old trailer.

I do not despise Walt, or scorn him, or resent the fact that his vote and mine are equal. In fact, I think of him with a real affection which is not especially condescending. I hope that he has his health and has stayed out of jail (he had a tendency to fight in bars when he could get to town) and has a nice place to live and can keep finding work for as long as he wants or needs to. But I am tired of pretending that the difference between my house and his company trailer is the result simply of the accidents of my good fortune and his bad breaks. I'm tired of playing at believing that we two are essentially identical and passive tools, that all things are otherwise equal, and but for aimless chance our positions might easily have been reversed. Of course chance was part of it—but what our mainstream post-Jeffersonian culture seems determined to ignore is this fact: I could do Walt's work as well as he could, but the reverse was and is not true. Walt was a truck driver and a hayslinger and a stockhand and a tractor driver. I was a truck driver and a hayslinger and a stockhand and a tractor driver. I learned his trade quickly and (in fact) I was trusted by our common employer with some jobs which would never have been left to the skill of a semi-barlow like Walt. But could Walt do *my* work as well as I can? I'm sorry, but he couldn't.

I claim no superior merit or virtue or utility inherent in my trade over Walt's. In fact, I am perfectly willing to acknowledge that mankind would eat if it had no professors of English, while it would starve if it had no farmhands. I freely acknowledge that there is a lot of humbuggery in the academy and that in some respects Walt works harder than I, and for (a little) less money. But the fact remains that Walt does what I could do, while I do what Walt could *not* do. I need not be arrogant to recognize and admit that simple equation and its implications. Perhaps we need to reflect, though, on the significance of the fact that in the America of the 1980s it seems daring and revolutionary (and makes people uneasy) to make so simple a statement as that one—that there are quite simply differences in the native capacities and capabilities of various people . . . and that pretending otherwise does dangerous violence to truth and good sense.

Lentils are harvested by combine, trucked and stored in bulk, and then sacked in burlap for shipment all over the world. Relatively small portions are bagged in plastic for domestic consumption. Bagged lentils conform to specifications of size and wholeness: the smallest lentils and the broken lentils are shunted aside and graded lower.

The lentils are simultaneously sorted and cleaned by an ingenious machine which uses big fans, gravity, and a series of screens to cull the more desirable ones.

A small lentil or a broken lentil is just as nutritious, just as full of protein and food value, just as much a lentil as the big one. But the big lentils go into burlap for shipment to Germany and Venezuela and other destinations spray-painted through crude stencils onto the bags, while the small and broken lentils wind up being shoveled by barlows into troughs for the livestock.

Walt and I—and you, reader—are of the same flesh, even as the large and the small lentils are of the same leguminous protein. But I will lay you odds that Walt is not living where the woodwork and floors are polished and pretty. I am humbly grateful for the luck (and the divine blessing) which has gone into bringing me to this place; the amount is enormous and far beyond anybody's deserving. But I am also tired of being compelled by fuzzy thinking to pretend that luck is the only reason for the difference between my house and Walt's. It is not, and one of the most important tasks facing sensible people in the last part of the twentieth century is the task of making it possible for people to acknowledge their competence without violating propriety. □

The Affirmative Action Complex

by Mitchell Bard

Racism and sexism are serious problems in this country. Ironically, the solution that has been devised for these ills is blatantly racist and sexist. Affirmative action calls for decisions to be made solely on the basis of race and sex—which is the very definition of racism and sexism.

Nevertheless, the government has decided that it is necessary to use this means of discrimination to redress past discrimination, and this procedure has been ratified by the judiciary. The impact of affirmative action, its supporters say, is that it has provided minorities and women with opportunities they otherwise would have been denied. This is the beneficial side of the policy, but there is also a negative side which is being ignored.

The focus of the debate on this issue has been on whether affirmative action is justified given the past discrimination and current biases in our society. There has been little or no attention, however, to the psychological consequences of this palliative. Those consequences, in fact, may be quite grave and involve the erosion of the values of individualism and personal responsibility.

The explicit message of affirmative action is that everyone should have an equal opportunity to health, education, and employment, but the implicit message is more sinister. That message is that all evils which befall an individual are the fault of society rather than the individual. Affirmative action has ratified the proposition that the historical and cultural prejudices of our society are the cause of problems encountered by individuals. This is something quite different, however, from the premise that affirmative action is needed because of the impact of these prejudices on certain *groups*.

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This affirmative action complex is probably most prevalent on the nation's campuses where these programs have been most liberally applied. Thus, for example, students who are not qualified to be in the university in the first place quickly find themselves unable to do the required work and, rather than take personal responsibility for their difficulties, blame society for failing to prepare them adequately. They say that the education they received in high school was not good enough or that they are not getting sufficient tutoring on the campus.

Those things may indeed be true, at least partially, but few students seem willing to accept, even as a possibility, that it may be their own inability or failure to study that is responsible. It is even more disturbing to find students who *are* qualified who believe that the burden of responsibility for their problems should be laid on someone other than themselves.

There is a saying that no one owes you a living, but affirmative action has created the perception that someone owes disadvantaged members of our society not only a living but a virtually problem-free existence. The only thing society should owe them, however, is an equal opportunity to become educated or employed. If the beneficiaries of that opportunity fail to make the most of it, then it is no more society's fault than if a white male fails to take advantage of his opportunity.

The problem could be solved by eliminating affirmative action. However, that is not going to happen so long as policy-makers believe that affirmative action programs are necessary to redress inequalities in our society. That being the case, it is important that we begin to recognize that the consequences of these programs are not benign and that affirmative action legitimates societal responsibility for personal failure.

At some point, and it may be nearer than some people think, the government will have to say that it cannot do any more for people. When that point is reached, the disadvantaged members of our society will have to stand on their own feet. In the meantime, we would be well advised to begin to condition the current beneficiaries of preferential treatment to the fact that they must accept responsibility for their lives. □

IDEAS ON LIBERTY

Education vs. Egalitarian Politics

If we give way before the force which now menaces higher education and our society as a whole, we are not only opening the door to second-rate standards and a new and more vicious and permanent form of injustice. We are also passing control of tomorrow's leaders and tomorrow's dominant ideas from the privacy and independence of the academic community to the realm of egalitarian politics. If Affirmative Action gains the final say in curriculum, faculty, and admissions throughout higher education, effective control of society will have passed to the social engineers and the politicians, and America will have lost one of her greatest resources in the struggle to remain an open and effective society.

—GEORGE C. ROCHE III
The Balancing Act

Defending the Market

by Tibor R. Machan

One of the greatest benefits many Western political systems bestow upon their citizens is a substantially free market economy. In this system individuals are not legally prevented from seeking their economic advantage in the company of others who may be counted on to do the same thing. While there is no purely free economic system anywhere, surely the main difference between Western liberal democracy and other political systems is the presence of the economic opportunity afforded by a relatively free market.

There are those who dispute this. However, even these critics usually do not deny the presence of greater economic opportunity in the West. Rather, they frown on the value of this opportunity. Critics from Left and Right have alleged the corrupting influence of a political system that does not hinder the pursuit of commercial prosperity.

These critics tend to see the free market as catering to base human inclinations—self-interest, greed, lust, and so on. When one is not much hindered, let alone prevented, from pursuing wealth, one will, the critics say, focus all one's attentions on this pursuit. Thus, we are told, free market systems give us the commercialization of everything from religion to art. Doctors do not worry so much about medicine as about prospering economically. Lawyers, evangelists, educators, scientists, artists, politicians—members of all vocations and professions with talent and skill concentrate predominantly on the bottom line.

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Now there is something to this charge, if we look only at the evidence before us in most Western societies. But it is unfair to judge the matter from a narrow empirical framework. For example, it needs to be stressed that economic liberty is a recent phenomenon, following centuries of repression and oppression during which prosperity was out of the question for most people in the world. It is therefore not surprising that for a few centuries people would focus their attention on attaining reasonable material prosperity, besides a number of other goals that are important to them.

In any case, my concern here is not so much with defending the free market system but with discussing one of the prominent ways in which it is defended against a persistent indictment. Professor Paul Samuelson, a critic of the free market system, has made the following serious charge against the free market: "The Invisible Hand will only maximize total social utility *provided the state intervenes so as to make the initial distribution of dollar votes ethically proper.*" (*Collected Scientific Papers* [Cambridge, Mass.: MIT Press, 1966], p. 1410 [emphasis in original])

In other words, the justice of such a system is predicated on the presence of a strong government that first distributes wealth equitably. If we start out with some people having much

more than others, with no moral justification, then the results of market processes will be contaminated with this initial defect of unjust distribution. From this indictment follow almost all the other indictments leveled at the free market—the rich get richer while the poor get poorer, the important professions lack support while trivial pursuits are well rewarded, and so on.

The Economist's View

Defenders of the market offer different replies but one of them is very prominent, coming from the best placed group of such defenders: economists. Professor Murray N. Rothbard summarized this defense most aptly when he wrote, "There is no distributional process apart from the production and exchange processes of the market; hence the very concept of 'distribution' becomes meaningless on the free market. Since 'distribution' is simply the result of the free exchange process, and since this process benefits all participants on the market and increases social utility, it follows directly that the 'distributional' results of the free market also increase social utility." ("Toward a Reconstruction of Utility and Welfare Economics," in Mary Sennholz, ed., *On Freedom and Free Enterprise* [New York: D. Van Nostrand, 1956], p. 251)

The crux of this defense is that apart from what people actually choose to do in a free market, there is no other measure of what is good for them. Putting it more generally, this is the subjective value theory defense: How can we dispute the free judgments of market agents as to what are the best decisions for them to make apart from the decisions they actually do make as they carry out their commercial transactions? And if there is no way to criticize those decisions, how could anyone propose that the overall results of market transactions are defective and require state intervention? There is, in short, no justification for state intervention because there is no standard of value other than what people in fact individually and freely invoke—and thus the result of such judgments that characterize collective or "social utility"—in free market systems.

But there is a serious implausibility about this defense. People may often be subjectivists in their general outlook, but in particular matters they are not. They may say that everything is relative as far as value-judgments are concerned—like beauty, goodness is merely in the eyes of the beholder. But when they see someone indulging in reckless purchases such as accumulating eight Rolls Royces, as did the late Liberace, or obtaining cocaine or pornographic books, they are perfectly willing to say that, contrary to the economist's theory, these people do not really benefit themselves in trade but are guilty of fadism, fetishism, excesses, immoderation, and so on.

These people will conclude, if they are without a contrary theory that accepts the legitimacy of ethical criticism of market behavior, that any society that makes it possible for people to be so indulgent must be ethically flawed. People quite reasonably dispute that "[the exchange] process benefits all participants on the market and increases social utility," at least as they observe the market in their particular situations.

They then go on to share the view of social critic John Kenneth Galbraith that the market produces many failures of distribution—people often fail to benefit themselves and their society when they produce and sell in the free market. Would it not be better that the money spent on pornography or heroin or even Michael Jackson gloves go to medical research, the arts, or economic education? Perhaps they won't know how to give a thorough philosophical defense of this conviction, but they will nevertheless hold it.

And they are right to do so. Free men and women can indeed make very bad, even evil judgments—there is no guarantee that when people enjoy freedom from the dictation of others, they will always choose to do the right thing. Anyone who proposes this view, as some economists do, will fly in the face of unshakable convictions and common sense. The very idea of freedom implies that one can do both good and evil while carrying on as a market agent. The details could only be known from close up, but they are no mystery—self-indulgent people are a dime a dozen. Misallocation of resources, therefore, is easy to conceive in free markets.

But does this not concede the case to those who wish to intervene in the market?

Not by a long shot. First of all, just as market agents can make bad judgments, so can those who would intervene with the behavior of market agents. And there are fewer pressures on these latter than on the former, since they enjoy "sovereign immunity" (e.g., government regulators cannot be sued when a mishap occurs in an industry they regulate, as is clear from recent accidents in airline transportation, chemical manufacturing, and so on).

But even more important, it is meaningless to talk of good human conduct without freedom. Persons who are fully or even only partially enslaved—dictated and forced to behave by others—simply cannot be given credit for good or evil conduct. They are in effect reduced to the status of robots.

Thus an unfree system is to the extent of its lack of freedom a dehumanized system. What needs to be accepted is that the utopian dream of making people perfect through limiting or regulating voluntary, self-regarding conduct is a dangerous dream, not some beautiful ideal as many suppose.

So the market must be seen as the best that we can do. Whatever failures it is exposed to can only be resisted by education, exhortation, example, but not by coercion. It will not do to deny that it is open to failure, as economists sometimes do, or to try to eliminate the failures by state intervention. And this should not be surprising—the quintessential human characteristic, after all, is our capacity for good or evil. Why should we expect any different from such a perfectly human enterprise as the pursuit of economic welfare? □

IDEAS ON LIBERTY

Only in Individuals

Society lives and acts only in individuals; it is nothing more than a certain attitude on their part. Everyone carries a part of society on his shoulders; no one is relieved of his share of responsibility by others. And no one can find a safe way out for himself if society is sweeping towards destruction. Therefore everyone, in his own interests, must thrust himself vigorously into the intellectual battle. None can stand aside with unconcern; the interests of everyone hang on the result. Whether he chooses or not, every man is drawn into the great historical struggle, the decisive battle into which our epoch has plunged us. . . .

Whether society shall continue to evolve or whether it shall decay lies —in the sense in which causal determination of all events permits us to speak of freewill—in the hand of man. Whether Society is good or bad may be a matter of individual judgment; but whoever prefers life to death, happiness to suffering, well-being to misery, must accept society. And whoever desires that society should exist and develop must also accept, without limitation or reserve, private ownership in the means of production.

—LUDWIG VON MISES,
Socialism

Privatization: Best Hope for a Vanishing Wilderness

by Lawrence W. Reed

"What nobody owns, nobody takes care of." That's a fundamental rule of human behavior and, at the same time, a powerfully favorable commentary on the institution we call "private property."

When something is owned by "everybody," it is often not cared for, either. The worst cases of pollution, for instance, tend to be on lands or in waters that supposedly we all own in common. That says something powerful about "public" property.

In a recent annual report, the President's Council on Environmental Quality put it this way: "Unowned resources are more likely to be over-exploited than resources privately owned and managed, since a private owner directly benefits from the preservation and maintenance of such resources and is thus more likely to act as a responsible steward."

These points are so fundamental to human nature and experience that they ought to be cast in stone and enshrined as natural law. Yet, when it comes to conserving America's natural environment, many people believe that government supervision of "public" property is the only game in town. The truth is that many of the very best examples of environmental preservation are the products of private groups and private property.

In the United States, more than 400 major private conservation organizations are actively engaged in saving natural things and places. Many other enterprises which do not have conservation as their principal objective, such as hunting ranges, end up conserving and enhancing Mother Nature as an important by-product of their activities.

What follows are thumbnail sketches of eight of these groups. That's not many, but those cited here are among the largest and/or most fascinating of the lot. All of them bear eloquent testimony to the general principle that private property does indeed serve the public good.

The Nature Conservancy

Sometimes referred to as "the real estate arm of the conservation movement," The Nature Conservancy (TNC) is the biggest outfit in the preservation business. Headquartered in Virginia, it is organized as a nonprofit corporation whose resources, its literature states, "are devoted to the protection of ecologically significant areas and the diversity of life they support."

TNC boasts current assets worth about a half a billion dollars, including 528,000 acres it owns outright. It manages conservation projects on more than three million acres in all 50 states, Canada, the Caribbean, and Latin America. Dues-paying membership now exceeds 350,000.

This burgeoning giant was founded in 1951. That's when its first volunteers worked out of their homes to raise funds for purchasing the Mianus River Gorge, an area of hardwood forests 30 miles from New York City. Thanks

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to aggressive fundraising and private gifts from landowners, the Gorge preserve has grown from 60 to 400 acres.

Businesses annually donate millions of dollars as well as thousands of acres which the organization's experts identify and approve as being of genuine ecological significance. Foundations and individuals are significant donors, too. Most of the rest of TNC's vast resources are raised by way of members' dues and gifts and a highly successful fundraising network. Though it frequently assists government agencies and sometimes even donates land to them, TNC gets no government money.

While radical environmentalists noisily lobby Congress for more "public" land, TNC goes about the preservation business in a quiet, capitalist fashion. Its approach has been likened to that of a cross between Adam Smith and Henry David Thoreau. After Consolidation Coal Company donated nearly 8,000 acres in central Illinois in 1984, one of that company's executives was quoted as saying of TNC: "They acquire land for, I believe, a very good purpose, but do so within the framework of the free market system. They do not seek to deprive individuals or businesses of their just property rights."

In the October 20, 1986, issue of *Sports Illustrated,* author Bil Gilbert described the way TNC operates:

> If, for example, TNC operatives hear of a plan to build a ski resort on a mountain that provides the last good habitat for a certain warbler, some rarish plants and an endangered beetle, they will view this with great alarm. However, they will not spring into action by issuing antidevelopment manifestos or bringing down public opinion or courts on the would-be seller and buyer. Rather, TNC agents will simply commence conventional commercial negotiations to buy the tract outright before the ski people do. If successful they will then exercise their property rights by leaving the place to the birds, plants and bugs and start looking to cut the next real estate deal.

Projects managed by TNC chapters, field offices, and/or professional land stewards are incredibly diverse. Among the hundreds of these are:

- Pine Butte Swamp in Montana: a protected wetland habitat for grizzly bear and two endangered plant species which spans 17,550 acres.
- Cache River/Bayou DeView National Wildlife Refuge: 4,398 acres of swamp and bottomland hardwoods, home for the nation's largest concentration of wintering mallards.
- Pelekunu Valley in Hawaii: 5,759 acres of the state's most pristine rain forests, sea cliffs, and free-flowing streams—a purchase made possible by a single anonymous gift of $1.5 million.
- King Clone creosote brush in California: 17 protected acres, home to an 11,700-year old ring of brush believed to be the oldest living organism on earth.

Some 3,200 species of plants and animals plus 1,700 communities of them are seriously threatened and require special husbanding, according to TNC estimates. All of them could be preserved if about 7.5 million more acres were acquired as sanctuaries. At today's market value, it's been estimated that would cost more than $3 billion, but it's a goal the organization nonetheless hopes to achieve by the end of the century.

Clifford Messinger once worked for another conservation outfit which spends much of its time lobbying for government to do the job. Disenchanted with that approach, he left and later joined TNC's Board of Directors. He explained his switch this way: "I began to realize that you can win a victory today in Congress but lose it eight years later. But if you actually own the land, it will stay protected."

That cogent remark not only summarizes the philosophy and work of The Nature Conservancy, but it underscores a key advantage of private over public property, too.

The National Audubon Society

Second to TNC in terms of land holdings, The National Audubon Society is now in its 82nd year and boasts 500,000 members.

Named for famed naturalist and wildlife painter John James Audubon (1785-1851), its first members joined together to protest cruelty to birds. That original interest has long since broadened into a multi-million dollar annual campaign on behalf of all wildlife and its natural habitat.

With a 30 million-dollar budget and a staff of 50, the nonprofit Audubon Society is a powerful force for conservation research and education. It regularly hosts ecology camps and runs environmental education centers, research stations, and 80 sanctuaries around the country. Its youth programs, designed to instill in youngsters a deep appreciation for natural things, last year involved 120,000 children in close to 4,000 classrooms. Its widely acclaimed magazines and television specials have brought a superb new dimension in wildlife education to millions of Americans.

Audubon's field programs include protection of marshes, bogs, wetlands, prairie potholes, hardwood bottomlands, endangered animal species and their natural habitats in all parts of the country.

Auduboners as a whole tend to be more politically active than members of The Nature Conservancy, but that often puts them on the same side of public issues as the most diehard defender of the free market. The scaling back of the federal government's controversial Garrison Diversion project in 1986 was perhaps their greatest political victory.

Garrison was a billion-dollar boondoggle designed to move the Missouri River eastward in order to irrigate less than one per cent of North Dakota land for the purpose of growing primarily surplus crops. As originally planned, it was to involve a 3,000-mile tangle of canals, pipelines, and reservoirs, providing each affected farm with what amounted to a $700,000 subsidy while destroying 70,000 acres of prairie wetlands and waterfowl habitat.

For years, Audubon fought Garrison in the courts and in Washington. Finally, in 1986, Congress voted to curtail the project substantially, thereby saving countless ducks, geese, shorebirds, gulls, and other animals from an unnecessary, State-induced demise.

Perhaps none of Audubon's efforts teaches a greater lesson than its Paul J. Rainey Sanctuary in the coastal marsh of southwestern Louisiana. The 26,171-acre preserve is totally owned and operated by the Society and is the winter home of tens of thousands of ducks, snow geese, coots, and wading birds. It also supports a thriving population of raccoons, otters, muskrats, white-tailed deer, alligators, and several species of both saltwater and freshwater fin and shellfish.

What's significant and instructive about the Rainey Sanctuary is Audubon's policy of allowing oil and natural gas wells to be drilled within its boundaries. By contract with private companies, all exploration, drilling, and production activities at Rainey are strictly monitored by Audubon. There has never been a blowout, an oil spill, or any measurable environmental damage to the 400 acres affected. All clean-up activities by the energy companies are meticulously scrutinized to ensure that the marshlands are properly restored. The arrangement has even generated revenues for Audubon to use for managing the preserve and for acquiring more land. Chalk up another one for self-interest, the profit motive, and private property.

Sea Lion Caves

Steller sea lions once swarmed along the Oregon coast by the thousands. Then, in the largely mistaken belief that the creatures were harming the salmon and tuna populations, commercial fishing interests prevailed upon the State of Oregon to declare a bounty on them. In 1920, the state legislature even instructed the State Fish Commission to exterminate the entire population of both seals and sea lions. In just the first year of the program, the top seven bounty hunters collected $5,000 each from state taxpayers at $5.00 per animal.

Other private individuals, alarmed at the slaughter, came to the rescue. Their lobbying eventually succeeded in ending the bounty and, in 1972, making the indiscriminate killing illegal altogether. But primary responsibility for saving the seals and sea lions of coastal Oregon must go to a private, for-profit organization called Sea Lion Caves, Inc.

Located just north of Florence, Oregon, Sea Lion Caves is a remarkable geological site—

North Maine Woods

America's largest sea cave and the only mainland rookery (breeding area) of the Steller sea lion. A 215-foot elevator takes visitors for just $4.00 each down into a large, domed cavern connected by three natural passages to the open sea. In a breathtaking scene, as many as 600 of the animals cast occasional glances at awe-struck tourists.

The 125 acres around Sea Lion Caves also serve as an important refuge for sea birds. Development has been purposely kept to a minimum by the owners to assure the area remains close to its natural condition. It has become a highly valued research location for naturalists, scientists, and students of geology, ornithology, marine biology, and natural history.

In 1977, Oregon Governor Robert Straub wrote that the property "was one of Oregon's great tourist attractions as well as a great and natural resource." He also praised it because it showed that, in his words, "a private organization can, by using a combination of common sense and good management, develop and protect such a great resource—and still show a profit."

The owners themselves, representing the same three families which first started the operation in 1932, make a claim with which few naturalists would disagree: "Had not the area been privately owned, developed and protected, especially in the early days when the State of Oregon paid a bounty for slaughtered sea lions, the Sea Lion Caves area would undoubtedly be devoid of sea lions and other marine life, and the natural wonder would probably not exist today."

North Maine Woods

A 2.8 million-acre tract of almost entirely private commercial forest and recreational land in northwestern Maine is attracting recognition from all over the Eastern Seaboard. Known as North Maine Woods, Inc., it has been described by the Council on Environmental Quality as "one of the most complex and innovative programs of multiple use of private lands for commercial timber production and public recreation in the country."

Though the principal purpose for the land was to husband and harvest valuable timber resources, North Maine Woods is open to recreational users. Its twenty owners formed the nonprofit corporation in 1974 to accommodate that second purpose. They regularly fund deficits between visitor fees and operating expenses. The owners include Boise Cascade Corporation, Great Northern Paper Company, and Irving Pulp & Paper, Ltd. The State of Maine owns a mere 5 per cent.

All the roads in the area have been privately built. Visitors use them to gain access to 123

camping areas, 11 canoeable rivers, and 252 lakes and ponds. Measures to ensure the safety of the 70,000 visitors each year have helped produce a spotless liability record.

Providing public recreation has been a costly undertaking for the private landowners, but revenues are now finally approaching expenses. Other landowners in the state have expressed interest in having the North Maine Woods organization manage their lands, too.

Extraordinary care for the land and its resources while accommodating recreational tourists has become a hallmark of the operation. This nurturing of the property's long-term integrity and productivity is a natural result of the private owners' direct financial interest in the capital value of the land.

People who make their living from the woods there go about their business near where others come to relax and enjoy the outdoors. Together they see to it, as North Maine Woods' literature puts it, "that, while they take forest products, fish, wildlife, and pleasure from this great region, they take nothing that will make it any less in the future than it is today."

Deseret Land & Livestock

Situated on 201,000 acres in five counties in northeastern Utah, Deseret Land & Livestock is a private, for-profit corporation owned by the Church of Jesus Christ of Latter-Day Saints (the Mormons). Its mission statement is "to make a profit, while at the same time improving the land resource and sharing the knowledge learned in the process," says General Manager Gregg Simonds.

Revenues are generated through a seed farm operation and a hunting range open to the public, but the 12,000 cattle raised on the land are the focal point of Deseret's profit-seeking activities.

What really makes Deseret an extraordinary place are the management's innovative techniques for nurturing the domestic livestock herd and enhancing the wildlife population simultaneously. The cattle are raised to "fit in" and complement the natural environment.

The amount of time the cattle are allowed in each of the ranch's more than 100 pastures is carefully limited. When it comes time to move them, a pickup truck with a police siren at the lead is all that's necessary because the cattle know that the sound of the siren means a new, fresh pasture. The practice allows the used pastures to recover quickly.

Conventional wisdom used to teach that cattle and wildlife are competitors, but Deseret's wildlife operation has proven that they can be entirely compatible—and profitably so. Large herds of elk and deer roam the ranch and are carefully culled each year by a limited number of fee-paying hunters. Prime fawning grounds are off-limits to livestock during critical times of the year. So successful has the program been that some of the ranch's elk are being transplanted to public lands to improve hunting there.

Additionally, dam-building beavers have been introduced into areas badly scarred by erosion. Ducks take advantage of the numerous reservoirs and catch basins established for cattle watering. And the ranch is moving into a new area—fisheries. It is establishing a natural hatchery for cutthroat trout.

Increasingly, Deseret's innovative methods of making good neighbors of livestock and wildlife are attracting national attention. Its example is likely to be imitated with ever greater frequency.

The remaining three groups are in a slightly different category from the previous five. They own little, if any, land. Private property incentives may *seem* to be a minimal factor in explaining the success of their projects, since much of what they do involves stewardship and improvement of *public* properties. However, their conservation work is private *initiative* in action, financed by private *donors,* all designed to rescue endangered lands, waterways, and wildlife from *public* neglect or mismanagement.

Ducks Unlimited, Inc.

For fifty years, the private, nonprofit group known as Ducks Unlimited has raised funds and conducted programs to restore and develop wetland habitat for wild geese and ducks. Founded in the depression year of 1937, DU has taken in nearly $400 million from gifts, dues, and fundraisers. Its 600,000 members

and 3,700 chapters are scattered all over Canada, the United States, and Mexico.

DU has built 3,200 habitat projects and reserved some four million acres of wetlands crucial to the survival of waterfowl. Rather than purchasing the land outright, it has cooperated with governments and individual landowners to secure long-term leases and easements. Following this pattern, DU implemented in 1984 a massive habitat construction program in a five-state area in the U.S. which accounts for nearly 30 per cent of the continent's waterfowl production.

Because it is an international organization, DU can cultivate the natural environment for birds beyond the borders of any one country. As one of its informational brochures states,

> Waterfowl neither adhere to geographical boundaries, nor do they respond to the political climates encountered along their migration routes. Because of this, and because of DU's unique ability to reach beyond U.S. borders, North American waterfowl are cared for throughout their continental migrations—something the Federal government has not been able to accomplish.

Of the acres DU has conserved, 3.8 million are in Canada, 410,000 are in Mexico, and 136,000 are in the United States.

Trout Unlimited, Inc.

Similar in structure to DU, nonprofit Trout Unlimited is the world's largest citizens' conservation organization dedicated to the protection and enhancement of cold-water fisheries.

In 1959 on the banks of Michigan's Au Sable River, 15 people formed TU. It now has 450 chapters and more than 50,000 members throughout the United States.

TU's activities on behalf of trout and other fish include public education programs, water quality monitoring, watershed protection, restoration of both damaged stream sections and the biological carrying capacity of entire streams, bank stabilization, and stocking of young fish in various water bodies.

The organization's "Embrace a Stream" program has funded over 135 local and regional cold-water conservation projects since 1982.

Conservation International

In July 1987, a new private, nonprofit, Washington, D.C.-based organization known as Conservation International made headlines all over the world. With funds provided by private donations and with Citicorp Investment Bank acting as its purchasing agent, the outfit bought $650,000 of the Bolivian government's $4 billion external debt, and then promptly forgave it. In return, Bolivia committed itself to setting aside 3.7 million acres of its public lands as conservation areas in its exotic Amazon basin.

This first "debt for nature" swap may well establish a pattern for reducing a major portion of the Third World's financial obligations. Already, CI and a number of other groups are negotiating to do the same thing again in areas where government policies have ravaged environmentally sensitive lands. The practice still leaves the properties in the hands of the State, but at least they are no longer fully subjected to destruction by uncaring "public servants."

In Bolivia, Conservation International will regularly monitor the government's efforts and provide the technical support needed to manage the site. High on its list for protection are the region's 13 endangered animal species and more species of birds than in all of North America.

CI is only a year and a half old but has already shown in a dramatic way that creative, private initiative can rescue what governments have callously jeopardized.

A Fruitful Partnership

So it is that private people and private property can be the best of friends to Mother Nature. Indeed, it is becoming increasingly apparent inside and outside the conservation movement that the incentives inherent in privatized affairs are potent motivators that many properties now "publicly owned" could sorely use. In any event, as this sketch of just eight groups suggests, it would be a grave mistake for anyone to assume that those doing the most or the best to conserve our natural environment must be wearing government uniforms. □

Communal vs. Private Property Rights

by James D. Gwartney and Richard L. Stroup

What is common to many is taken least care of, for all men have greater regard for what is their own than for what they possess in common with others.
—***Aristotle***

The point made by Aristotle more than 2,000 years ago is as true now as it was then, and it is as important in primitive cultures as it is in developed ones. When the property rights to a resource are communally held, the resource is often abused. In contrast, when the rights to a resource are held by an individual or family, conservation and wise utilization generally result.

This point is ancient, but it is often missed today. Americans seem to be trying to make more and more property communal by allowing the government broad zoning powers and increasing public ownership of wilderness and parkland. Many people believe that the government protects resources more effectively than private individuals do, even though history shows exactly the opposite to be true.

The following examples, ranging from the sixteenth century to the present day, and from cultures as diverse as the American Indians and Communist Russia, illustrate the value of private property rights and the difficulties posed by communal property.

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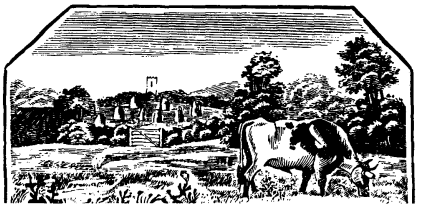

1. Cattle Grazing on the English Commons

In a famous 1968 essay, "The Tragedy of the Commons," Garrett Hardin used the England commons to illustrate the problems of communal ownership. In the sixteenth century, many English villages had commons, or commonly held pastures, which were available to any villagers who wanted to graze their animals. Since the benefits of grazing an additional animal accrued fully to the individual, whereas the cost of overgrazing was an external one, the pastures were grazed extensively. Since the pastures were communal property, there was little incentive for an *individual* to conserve grass in the present so that it would be more abundant in the future. When everyone used the pasture extensively, there was not enough grass at the end of the grazing season to provide a good base for next year's growth. Without private ownership, what was good for the individual was bad for the village as a whole.

In order to preserve the grass, pastures were fenced in the enclosure movement. After the enclosure movement established private property rights, overgrazing no longer occurred.

Each owner had a strong incentive to protect the land.

2. The Property Rights of American Indians

Among American Indian tribes, common ownership of the hunting grounds was the general rule. Because the number of native Americans was small and their hunting technology was not highly developed, the hunted animals seldom faced extinction. However, there were at least two exceptions.

One was the beaver hunted by the Montagnais Indians of the Labrador Peninsula. When French fur traders came to the area in the early 1600s, the value of beaver pelts rose. The Indians hunted them more intensively and the beaver became increasingly scarce. Recognizing the depletion of the beaver population and the animal's possible extinction, the Montagnais began to institute private property rights, as Harold Demsetz has discussed in a 1967 *American Economic Review* article. Each beaver-trapping area on a stream was assigned to a family, which then had both the incentive and the ability to adopt conservation practices. A family never trapped the last remaining pair of beavers in its territory, since that would harm the family the following year.

For a time, the supply of beavers was no longer in jeopardy. However, when a new wave of European trappers invaded the area, the native Americans—unable to enforce their property rights to the beaver or to their land—abandoned conservation. They took the pelts while they could. Individual ownership was destroyed, and conservation disappeared with it.

The second animal that faced extinction was the communally owned bison or American buffalo, which roamed America's Great Plains. For many years, the buffalo and the migrating bands of Indians lived together in relative harmony. Buffalo were difficult for Indians to kill, and when they got one, they used it very carefully. But once native Americans gained access to both the gun and the white man's market for hides, their ability and incentive to kill the buffalo increased. There was no owner to protect the buffalo herds, and any one Indian—or even a tribe—who killed fewer to save more for next year was unlikely to benefit since other Indians next year were much more likely to take the conserved buffalo. By 1840, reports Francis Haines in *The Buffalo,* Indians had emptied portions of the Great Plains of the area's large buffalo population.

In this case, the communal property problem could not be solved by the Indians. Unlike the beaver, the buffalo ranged widely over the Great Plains. Individual, family, and even tribal rights were impossible to establish and enforce. Like oil in a common pool or the sperm whale on the high seas, buffalo were a "fugitive resource," and their mobility made property rights (and therefore sound management) unattainable. Only the later invention of barbed wire and the fencing of the range solved the problem, after most buffalo herds had already been destroyed by both Indians and whites.

3. Property Rights in the Soviet Union

In the Soviet Union, most farmland is cultivated collectively. The output of the collective farms goes to the state. As a result, most of the benefits derived from wise conservation practices and efficient production techniques accrue to the state rather than to the individual workers.

Families living on collective farms are permitted to cultivate a private plot, the area of which is not to exceed one acre. The "owners" of these private plots are allowed to sell their produce in a relatively free market. Although these private plots constitute approximately one per cent of the land under cultivation in the Soviet Union, the Communist press reported that in 1980 about one-quarter of the total value of agricultural output was generated by these plots. The productivity per acre on the private plots was approximately 33 times higher than that on the collectively farmed land!

Property rights make a difference even in the Soviet Union. Clearly, the farm workers take better care of the plots they own privately than the land they own communally. These three examples assure us that Aristotle would be satisfied with the long-range accuracy of his observation. □

Ethics and Bottle Deposits

by Richard R. Mayer

We seem to have abandoned ethics in our public lives. Bottle deposit laws, which in many parts of the country require mandatory deposits and mandatory payment for returned bottles, are a good example.

I shop in my home town at Sulli's Supermarket. Actually it's not too super, as supermarkets go, but it's convenient and reasonably pleasant. I don't recall ever having been pressured to buy something I didn't want, and certainly Joe Sulli has never threatened to call the police if I didn't purchase a particular item.

Yet, under our state's bottle deposit legislation, I am in a position to do just that to him—threaten sanctions if he doesn't buy from me the bottles I offer at five cents apiece. That I can't do.

It is said that this is merely the refund of a deposit made at the time of purchase, or that it helps improve the environment. Both arguments fail.

The bottle is mine, to do with as I wish (calling the five cents a "deposit" doesn't change that). I may use the bottle at home for a flower vase, bust it up, give it to a friend, or sell it. So when I tender it to Mr. Sulli for a "refund" I am really asking him, under state coercion, to buy something he may not want. That is unfair.

So far as littering is concerned, that's my problem, not his. Yes, I may toss out the bottle along the street; but that's a fault of mine, not the grocer's.

And if we look more closely we see that littering is mostly a problem with "public" lands, not property which is privately owned. Most people don't throw empties onto their own lawns; for those who do, let them live that way. Nor is it much of a problem in such places as shopping malls, churches, theaters, and social clubs. It usually isn't done there; if it is, the owner cares enough to police it.

Littering is a problem only on such government-controlled lands as highways, parks, and schools. And that is because we have lost respect. The public doesn't care about common lands anymore and state officials don't care enough to pick up litter on their own.

We also hear that the beverage industry realizes a windfall from unclaimed deposits. This may be true, but that's not the issue.

The problem is not with the merchant, and it is not between the merchant and me. Rather, it is between us and the state which requires the merchant and me to do what neither of us wants—otherwise there would be no need to coerce both "deposit" and "refund."

And it is an ethical problem, a question of what is fair and honest. The merchant may not represent my ideal of virtue; indeed I may feel it a rip-off when he tacks on the extra five cents to the price. Still, it was not his idea to begin with. Should I thus do the same to him just because I have the chance? Should I demean myself to the point of calling the cops if Mr. Sulli doesn't buy back from me the bottle he doesn't want? After all, he was thoughtful enough to make available the refreshment I sought in the first place.

No, in my case I have a choice; and I should consider what is fair.

The five-cent bottle deposit may not rank with abortion or terrorism as an ethical issue. Still, it is a matter of ethics and as such is important. Are we to say that some wrongs are less wrong than others? Or that we should only do what we see as right in larger matters? Or that for a nickel I'll do what is rather uncivil? Will we draw the line on harder issues or larger amounts if we won't in the case of five cents?

I think not. □

Mr. Mayer is a surveyor living in Schuylerville, New York.

The Primacy of Freedom

by Brian Summers

There is a time to ask basic questions. Now, as we mark the retirement of Dr. Paul L. Poirot, who has contributed so much time, energy, and wisdom to the cause of liberty, it is perhaps appropriate for each of us to ask himself: Why should I follow this man's lead and dedicate myself to advancing the freedom philosophy?

On the surface, this seems like a trivial question. Liberty is good, and we should devote ourselves to good causes. But, as we all know, there are other things we can do with our lives and other ways to spend our money. Why is liberty so important that we should devote our efforts toward it when there are so many other worthy causes which cry for our attention and support?

One way to answer is to point out that the freedom philosophy, according to all available evidence, is correct. Both rational thought and historical study demonstrate that the free market, private property, limited government system works—it delivers higher living standards than any alternate system. If truth be known, then it is our duty to advance it.

But the same applies to other disciplines. We can find truth in mathematics, the arts, the sciences, and at least parts of various philosophical systems. If one's concern is the truth—and I believe that our allegiance to the truth must precede our commitment to any endeavor—then the freedom philosophy should have no greater claim on our lives than any other demonstrably true system.

But the freedom philosophy is concerned with more than the truth. It is concerned with people. It analyzes the institutions and laws which enable people to prosper and grow, as well as the institutions and laws which have brought destitution, suffering, and death to millions of victims. The freedom philosophy is important because people are important.

This is not to trivialize other disciplines or to say that no one should work in a field which, for some of us, is less important than our overriding concern with freedom. If everyone were working for liberty to the exclusion of everything else, there would be no farmers, craftsmen, doctors, or any of the other people who keep us alive. Furthermore, if all intellectuals concerned themselves exclusively with the freedom philosophy, the world might be a freer place, but it would be devoid of the arts which enrich so many lives.

However, I think that, from time to time, we should take a long-term look at things. Sure, the arts and sciences are important. What would life be without them? But I think we also should give some thought to the institutions which enable such disciplines to flourish. We should ask ourselves why so many human advances have come from relatively free societies. We should ask why totalitarian nations not only have to steal our technology, they can't even feed their own people.

Consider, in particular, medical care. I marvel at the advances in medicine and medical technology, and I applaud those who freely

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This piece appeared in Ideas on Liberty: Essays in Honor of Paul L. Poirot, *an anthology to mark Dr. Poirot's thirty years as Managing Editor of* The Freeman.

contribute their time and wealth to support medical care and research. There is no belittling their contribution. But again, I think it is important to give some thought to the social system which creates the wealth we contribute, as well as consider the institutions which best facilitate an adequate diet, sanitation, technological, biological, and chemical advances, and which foster a spirit of open inquiry. It also is instructive to consider first-hand reports of people who have witnessed the appalling medical systems in totalitarian states.

If, as I contend, the freedom philosophy is so important, the question then becomes—not why should anyone devote his life to advancing this philosophy—but why don't *more* people work for liberty? Why—when resources are being squandered at an incredible rate, when billions of people continue to suffer in abject poverty, when statism unleashes its fury in seemingly endless wars and acts of terrorism—why doesn't the great mass of humanity cry "Enough!" and throw off the shackles of enslaving governments?

A Lack of Understanding

The answer, in short, is that they don't understand. And we shouldn't be surprised, since in most cases, people never have been told the basic precepts of the freedom philosophy. For more than a generation, the task of explaining these precepts has fallen largely on the shoulders of Paul Poirot, his colleagues at The Foundation for Economic Education, and the authors and speakers who work with this Foundation.

It is difficult to measure the success of these educational efforts. However, we see encouraging signs in our daily contacts with friends and acquaintances, as well as in the mass media. In particular, there seems to be a growing awareness of the need for economic incentives, of the dangers of protectionism, and of the disruptive consequences of an expansionary monetary policy.

This is a start. And FEE has played a major role in this growing understanding of basic economics. In fact, it can be argued that The Foundation for Economic Education has been the wellspring of this understanding. One can make an impressive list of the educators, journalists, clergymen, and political leaders who have received our publications and attended our seminars.

But this is not enough. For one thing, the level of economic illiteracy is still appalling. How many people can explain the causes of the Great Depression? How many know that the gas lines which plagued us in the 1970s had nothing to do with OPEC, and everything to do with price controls? How many have any understanding of how government spending is diverting billions of dollars from our nation's capital base? The list could be expanded almost at will.

Beyond the baneful consequences of economic illiteracy lies an even more troubling failing—the inability to make connections. The next time there is a documentary about war, or famine, or death camps, watch it. Look long and hard at the suffering faces. Then ask yourself why these things happen. Can you explain why these are not natural occurrences, that they have economic and philosophical causes?

Or visit a hospital and marvel at the medicines and medical technology. Can you explain why these advances are available now, after several centuries of relative freedom in a few capitalist countries, while for thousands of years and in most nations the diseases we now conquer as a matter of course were a death sentence? Why here? Why now? And why not sooner?

I will not attempt to answer these and similar questions in the space of this essay. These questions have been raised and answered for more than a generation in the pages of *The Freeman,* FEE's various books and pamphlets, and FEE lectures and seminars. The Foundation for Economic Education asks the important questions, and hundreds of thousands of lives have been influenced by this Foundation's work.

But even if we could reach every man, woman, and child with sound economic arguments, even if we could sit them all down and lecture to them on economics for a month, it still wouldn't be enough, because economics isn't enough. Economics isn't even the most important part of the case for freedom. This, in

PAUL L. POIROT

Paul L. Poirot

On December 6, 1987, Dr. Paul L. Poirot was honored for his many years of dedication to FEE, The Freeman, *and the cause of liberty. The gathering included FEE trustees, current and former staff members,* Freeman *authors, and family and friends of Dr. Poirot.*

Dr. Poirot joined the staff of FEE in 1949. When The Foundation began publishing The Freeman *on a monthly basis in 1956, Dr. Poirot was named managing editor—a post he held for 30 years.*

Upon his retirement last year, Dr. Poirot was elected a Trustee, with life tenure, of The Foundation for Economic Education.

fact, is the primary thing for those of us engaged in economic education to remember.

The only reason I can down-play the role of economics in advancing the cause of liberty is that there is something which is so much more important: moral principles. Freedom is right because it is morally right. Government intervention in peaceful affairs—no matter at whose behest, and no matter what the excuse—is wrong.

Fortunately, while many people are turned off by economic arguments or have trouble with abstract concepts, almost everyone has some understanding of right and wrong. The difficulty is in getting them to see that the free market, private property, limited government system is the only social system in keeping with sound moral principles. There is further difficulty in convincing people that when government, acting as someone's agent, harms one person to benefit another, then the person who used the government for his own ends is as guilty of plundering another as if he had committed the act himself.

But this moral education can be done. In fact, for more than thirty years, Paul Poirot and his various authors did a masterful job of explaining moral principles and showing how they apply to public issues as well as to private matters.

By and large, *The Freeman* has been the only publication doing this vitally important work of attracting people to the freedom philosophy by presenting the free market, private property, limited government system as an ideal moral system—one we would want our children to inherit. This, more than anything else, is what has made The Foundation for Economic Education not only unique, but what makes it the hub of the entire freedom movement.

Let us thus, at this occasion, thank Paul Poirot for his tireless efforts, his wise counsel, and his steadfast commitment to the highest principles—and rededicate ourselves to upholding the moral principles which are the key to our success as individuals, as a Foundation, and as a nation. □

Economic Power

by Joseph S. Fulda

Economic power is a recurring theme among political theorists ranging from radical political economist John Kenneth Galbraith on the left to neoconservative intellectual Irving Kristol on the right. The doctrine that wealth is power is almost never challenged in our day and in many rather subtle ways has come to underlie much public policy: Public campaign financing, campaign contribution limitations, equal time, antitrust laws, and estate taxes are examples. This concept, which originated in the late nineteenth century and has since lain dormant in the public mind, needs re-examination.

Any analysis of economic power must begin with a clear conception of power and its antithesis, liberty. Power, as I understand it, is the capacity to rule others: to make decisions for them without their consent and, in particular, to allocate their time and direct their energies. Liberty, in contrast, is a condition of noninterference and self-rule in which people make decisions for themselves without asking any man's leave and in which they themselves apportion their time and channel their energies in such manner as to them seems most satisfying.

An Unholy Alliance

If the capacity to coerce is the sum of power, it is hard to see how it inheres in a pile of riches. The usual reply is that wealth can be used to obtain instruments of coercion along with those willing to use them, and that power can indeed be found in a stockpile of weapons and men of violence. Now this is all very true, but inasmuch as the unholy alliance between wealth and force, public and private, is universally proscribed in free republics, it cannot account for the tirades, so common in the media, against economic power. Neither bribery nor organized crime, typical examples of the alliance, is the object of their fulminations. Economic power in that sense has no apologists and, therefore, no detractors.

Nor is it the holders of power, as we have defined it, who stand accused of its use in the economic realm. Indeed, government is seen as the enemy of economic power, Galbraith's "countervailing power," the embodiment of Kristol's populist temper. Government may indeed tax, subsidize, regulate, and monopolize, but it is rather the wealthy and the corporations who are said to enjoy economic power. But the only power which properly attends on wealth alone is *dominium:* "the complete power to use, to enjoy, and to dispose of property at will" (*The American College Dictionary*). But is this power? That is, is it control over one's own domain or control over the domain of others? Far from being a "power," dominium is a liberty, the liberty to do with the fruits of one's labor and the return on one's investment as one wills.

Market "Power"

Thus, proponents of the concept of economic power must be referring to something other than power over the economy. What they

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mean, in fact, by "economic power" is the ability to influence a variety of social and economic conditions through the use of one's wealth in a volitive, rather than coercive, manner. In a market society, those with the most purchasing "power" ultimately decide what will be produced in greater measure than those with less purchasing power. Likewise, those with the most to invest will proximately decide what goods will be produced and what services will be offered in greater measure than those with less to invest.

Yet this influence over the free economy is central to its operation: Either what is produced will determine what will be consumed, as in the command economy, or what will be consumed determines what is produced, as in the market economy. Likewise, either profits and losses will take capital from those not satisfying consumer wishes and reward those more sensitive to others' needs, or capital will be allocated and production decisions will be made in accordance with political, rather than economic, criteria.

The notion of economic power, then, is really nothing other than what an honest socialist would admit is economic freedom, what Marx called "that single, unconscionable freedom." This freedom, mistakenly labeled power, is often resented when it comes to play in the political sphere; this resentment leads to all manner of "election reforms." It is also resented in the economic sphere, and leads to a variety of anti-competitive "regulatory reforms." It is perhaps most resented in the social sphere—just recall Mrs. Reagan's difficult first months as First Lady—and results in sweeping demands for a new social order.

What is really resented is the necessarily unequal nature of this influence that will always obtain when men are left free. The gurus of the far left denounce concentrations of wealth as power, because the resulting influence over who will lead and what will be produced and consumed is something they feel is best left with them and their plans for our future.

The Hypocrisy of Collectivism

What other explanation can honestly be put forth for collectivist denunciations of wealth in capitalist society, in view of their decidedly hypocritical "solution"? After all, they propose to combine all corporations into one giant Corporation, to endow it with all natural resources, to arm it, to invest it with legislative and judicial powers, to grant it the police power, to imbue it with quasi-spiritual authority, to place its public relations department in charge of the media and its acquisitions department in charge of the military and then, as final sublimating acts, to replace a much-decried self-perpetuating board of directors with a self-perpetuating Party elite and to simply rename this new Corporation, the State.

That is the socialist prescription for concentrations of *both* wealth *and* power, and it is a very clear guarantee of poverty, misery, and tyranny, the three things alone which socialism has produced beyond comparison. Not for nothing is socialism thus sometimes, however inaccurately, described as "state capitalism"! If one is truly interested in limiting economic power, one should consider limiting government—for that is where power properly understood lies. □

In the March *Freeman:*

" 'Blat': Corruption in Eastern Europe" by Michael Brewer

"Rewarding Uniformity" by Kenneth A. Bisson

"The Great Depression" by Hans F. Sennholz

The Self-Interest of Self-Regulation

by J. Brian Phillips

Proponents of government regulation often overlook the many ways in which the free market itself polices producers, without the need for government involvement. Let us make a quick survey of these ways, in the hope that it will help us better to understand the market process, as well as shed further light on the wisdom of government intervention.

Almost all businessmen realize that to succeed they must please the buying public. A satisfied customer most likely will become a regular customer. A dissatisfied customer will not return, and too many dissatisfied customers will cause a business to fail. Consequently, the businessman has an interest in providing his customers with quality products and services at reasonable costs.

Honest businessmen, who are well aware of the importance of customer goodwill, try to insure that their businesses are not harmed by the unscrupulous actions of others. Many of them have formed voluntary associations to provide self-regulation in their industries.

It is important to understand the differences between a voluntary association and a government agency. The fact that the former is voluntary and the latter is compulsory is the fundamental distinction. But this leads to other differences.

Government agencies are political bodies. Consequently, political expediency often has as much to do with a regulation as any legitimate economic or ethical concern. Furthermore, government regulatory agencies are established for the express purpose of protecting consumers. And herein lies the unspoken premise: that the interests of consumers and producers are inherently at odds.

Voluntary associations are established precisely because this assertion is false—honest businessmen want to protect both consumers and themselves from dishonest businessmen. Voluntary agencies operate on the premise that the interests of consumers and producers do not conflict and, in fact, are often the same.

Government regulatory agencies ultimately set producers against one another, as each tries to secure political privileges for himself. Voluntary associations operate cooperatively, as producers realize that their mutual needs can be better served by working together.

All of this sounds good on paper. But do businesses really attempt to promote the interests of both consumers and producers? Is practice consistent with theory?

Most trades and professions have some form of professional association. Many of these are little more than fraternal organizations. Others would be more accurately described as political action committees. But many provide some form of self-regulation within their trade through the inspection of facilities, the establishment of a code of ethics, and/or the arbitration of disputes. Businessmen across the nation recognize the self-interest in self-regulation.

For example, the Greater Houston Builders' Association (GHBA) is a voluntary organization whose members include insurance, mortgage, and title companies, banks, subcontractors, material suppliers, and many other

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trades, as well as builders. The association's primary purpose is to further the interests of its members through advertisements, promotions, the arbitration of disputes, and by watching for legislation which will adversely affect the building industry.

But the association also promotes the interests of consumers. Its Code of Ethics states, among other things: "Honesty is our guiding business policy. High standards of health, safety, and sanitation shall be built into every residence. Members shall deal fairly with their respective employees, subcontractors and suppliers."[1] GHBA members can use the association's logo in their advertisements, indicating to consumers that the business has pledged to uphold these principles. When disputes do arise, consumers have not only the local GHBA to turn to, but also state and national builders' associations.

On a state level, the Bed and Breakfast Society of Texas (BBST) offers self-regulation to approximately 75 bed and breakfast establishments across the state. BBST is a privately owned business which also serves as a reservation service for its members. BBST owner Marguerite Swanson has a background in guidance and counseling, which she uses to screen potential guests. Because many of the bed and breakfasts are located in private homes, this screening process prevents the dilemma of an unexpected guest suddenly appearing at one's door. This provides members with a degree of protection.

To join the BBST, an establishment must meet Mrs. Swanson's guidelines. These include a separate bathroom for each guest bedroom, fresh fruit for breakfast, and more subjective criteria such as comfort and safety. Mrs. Swanson personally inspects each establishment and looks for "the kind of accommodations that I and all the people involved with bed and breakfast would actually seek ourselves."[2] She also teaches several courses in running a bed and breakfast, which member hosts and hostesses must periodically attend.

Consumers benefit from the BBST because they are guaranteed quality accommodations at reasonable rates. Additionally, Mrs. Swanson tries to match guests with compatible hosts, making the experience more pleasant for everyone. She must be successful, because she always has a backlog of bed and breakfasts wanting to join her association, and most guests are repeat customers.

A more widely known example of self-regulation is the Better Business Bureau (BBB). Established in the early 1900s "to combat untrue advertising and set standards for advertisers,"[3] BBBs exist in nearly every city in the country. Today the BBB has three primary goals: maintaining truthful ads, early detection of fraud, and arbitrating consumer disputes. A BBB pamphlet states that the organization "is devoted to the protection of the consuming public and to the vitality of the free enterprise system. It works to fulfill its mission by fostering the highest standards of responsibility and probity in business practice, by advocating truth in advertising and integrity in the performance of business services."[4] Clearly, the BBB and its members recognize the self-interest in self-regulation.

Another form of self-regulation includes authorized and limited dealerships. This method insures consumers that the local businessman is in good standing with the manufacturer and is qualified to sell and/or service a particular product. When dealerships are limited, dealers must maintain high standards or the manufacturer may withdraw its authorization and present it to a competitor.

In addition to these various forms of self-regulation, the free market has provided a number of other means of promoting consumer awareness and exposing fraudulent business practices.

Underwriters' Laboratories (UL), for example, is an independent testing agency established by insurance underwriters. One of the first such agencies, UL tests nearly every electrical appliance put on the market today. Manufacturers are charged a fee to have UL test their products, and those that meet their standards may use the UL label on their products and in their advertising. This label is now widely recognized as a symbol of safety and quality.

The monthly magazine *Consumer Reports* is published by Consumers Union, an independent "nonprofit organization established in 1936 to provide consumers with information and advice on goods, services, health, and per-

sonal finance . . . ."[5] Consumers Union makes anonymous purchases at retail outlets, tests the products, and publishes the results. To avoid conflicts of interest, and maintain its independent status, Consumers Union does not allow manufacturers to advertise in its magazine, nor does it award a "Seal of Approval." They merely test and report on consumer products, so that consumers can judge for themselves which products best fit their needs.

However, *Good Housekeeping* magazine does award a "Seal of Approval" which manufacturers can use on their products and in their advertising. In awarding the seal, the magazine guarantees to replace or refund the cost of any defective product. Obviously, to make such a guarantee, the magazine is confident of the product's quality, and the consumer is guaranteed satisfaction.

Honest businessmen have a vested interest in exposing fraudulent practices. The organizations we have examined demonstrate that businessmen recognize this and are willing and able to protect their self-interest through the voluntary, peaceful means of the free market. In the process, they also protect consumers. □

1. Pamphlet distributed by the Greater Houston Builders' Association.
2. Interview with Mrs. Swanson.
3. Pamphlet distributed by the Better Business Bureau of Metropolitan Houston.
4. *Ibid.*
5. Masthead statement, *Consumer Reports*.

IDEAS ON LIBERTY

Wanted: Cooperation

From the awareness of the limitations of individual knowledge and from the fact that no person or small group of persons can know all that is known to somebody, individualism also derives its main practical conclusion: its demand for a strict limitation of all coercive or exclusive power. Its opposition, however, is directed only against the use of *coercion* to bring about organization or association, and not against association as such. Far from being opposed to voluntary association, the case of the individualist rests, on the contrary, on the contention that much of what in the opinion of many can be brought about only by conscious direction, can be better achieved by the voluntary and spontaneous collaboration of individuals. The consistent individualist ought therefore to be an enthusiast for voluntary collaboration—wherever and whenever it does not degenerate into coercion of others or lead to the assumption of exclusive powers.

—F. A. HAYEK,
Individualism and Economic Order

The "New Socialism"

by John K. Williams

Five years ago my native country of Australia elected a socialist government. A perusal, however, of legislative measures taken by that government leads one to ask precisely what the label "socialist" today means, at least in Australia.

The socialist government floated the Australian dollar, thereby partially entrusting the nation's currency to market forces rather than to political control. It deregulated banking and numerous other industries. It cut marginal tax rates. It froze, and in some cases actually cut, social security benefits and tightened eligibility requirements for welfare. It is now planning to sell government-owned enterprises to the private sector. Our socialist Prime Minister and Treasurer regularly speak of the importance of incentives, the significance of market forces, the necessity for capital formation, and the crucial role of private property rights in achieving prosperity.

This, on any showing, is extraordinary. Australia embraced the welfare state very early in the twentieth century, well before the United States. The socialist party, traditionally, has defended and sought to expand the welfare state. Yet here is a socialist government cutting back on the welfare state and implementing policies one might expect from a conservative government.

This "new-look" socialism is not unique to Australia. The most startling manifestations of socialists flirting with freer markets are those emerging in the Soviet Union and China. Speculation is rife as to the significance of Mikhail Gorbachev's drastic reforms of the Soviet economy, but the nature of these reforms is clear. Factory managers, not socialist planners in Moscow, are to determine what is produced and in what quantities, and this determination is to be related to consumer demand. Profits and incentives are being lauded as the key to economic efficiency. Tony Benn, one of the radical left-wingers of British politics, bluntly stated, after a recent trip to Moscow, "What Gorbachev is saying is that the old revolutionary centralism has ended up in a nightmare, that it has paralyzed initiative. I think he's right." (*The New York Times*, July 19, 1987)

China's experiments with freer markets are further developed. A volume of essays by Chinese economists (D. Xu, *et al.*, *China's Search for Economic Growth* [Beijing: New World Press, 1982]) anticipated in theory what recent practice has implemented. The essayists without exception stressed the importance of capital, the need for incentives, and the significance of a system of property rights which approximates in many respects what we would call private property. "Authentic" socialism is given a new definition: "From each according to his ability; to each according to his work."

And so the story goes. Austria is debating selling off 49 per cent of many state-owned businesses to the private sector. Britain under Margaret Thatcher has privatized British Telecom, Rolls-Royce, and other state-owned firms with a total value of more than ten billion dollars. France, with a socialist President, has sold off four of the largest socialist enterprises

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and plans to privatize 65 companies in all. Regardless of the alleged political commitment of whatever party happens to be in power, the trend seems to be toward freer markets and away from old-style socialism.

Why this trend? Let me offer four answers and sketch them by reference to Australia's experience.

First, the socialists began to question a question! For years Australian socialists asked, "Why poverty?" They assumed, as most of us assume, that material abundance is the norm, the state of affairs to be taken for granted. Laden shelves and groaning freezers in supermarkets came to be expected; the oddity requiring explanation and remediation was poverty.

Yet historically the vast majority of people who have walked this earth have known only grinding, soul-destroying destitution. The historical oddity crying out for explanation is not poverty, but material abundance and prosperity.

Australian supporters of socialism and the welfare state had for decades taken wealth creation for granted and concentrated on how wealth should be redistributed. But historical and economic reality have now forced them to ask a different question: How is wealth *created*?

Focusing on that question has forced them to look toward the free market economy. There is still, of course, a desire to redistribute wealth. All that Australian socialists have realized is that goods that do not exist—goods that have not been created—cannot be distributed at all! They are hoping that somehow they can trust the free market economy to create wealth, and then intervene to redistribute that wealth.

Yet that hope turns, I suggest, on a dubious presupposition: that it is possible to separate the way the free market creates wealth from the way this market process distributes goods and services. The catch is that in the free market, private property system, there are no unowned goods to be distributed. Machinery is owned. Tools are owned. Goods are owned at every stage of the production process. A redistribution of goods must be preceded by a forced expropriation of those goods. By definition, that involves a drastic modification of private property rights—the key to the market's creative genius, as free market economists long have insisted and the brightest of contemporary historians are confirming.

Second, a preoccupation with the redistribution of wealth inexorably led Australia to progressive taxation and high marginal tax rates. But it was discovered that, like it or not, the simple equation, "High taxation rates yield large taxation revenues" had ignored one vital factor: A high marginal tax rate constitutes a low cost of leisure, and if the cost of leisure is low more people will choose leisure than paid, productive employment.

It makes sense. Suppose you earn $100 a day. On Monday you pay tax at the rate of 20 per cent. Should you choose not to work and opt instead for leisure, you surrender $80. That $80 is the cost to you of choosing leisure. And it's high. On Tuesday you pay tax at the rate of 40 per cent. That means you retain $60 of the $100 you earn. The cost to you of not working —that is, of choosing leisure—has dropped from $80 to $60. On Wednesday you pay tax at the rate of 60 per cent. A day of leisure now costs you a forgone $40. Imagine that on Friday you pay tax at the rate which applied in pre-Thatcher Britain: 98 per cent! Choosing leisure now costs you a mere $2! One would be crazy not to choose that bargain-priced leisure! But when sufficient people so choose, a community's productive output drops.

And that is but the tip of the iceberg. Not only do high marginal tax rates discourage production, they also discourage capital formation —the investing of assets in machinery, tools, and so on. The key to any people's prosperity is the capital invested per worker. A people failing to replenish or increase its capital invested is pleading for drastically reduced productivity.

The Fall of Australia

At the turn of the century Australia was among the three wealthiest nations on earth in terms of that admittedly dubious measure, Gross Domestic Product per person. Seven decades of the welfare state, and the high marginal tax rates such necessitates, have seen

Australia plummet to about thirtieth! Capital invested per worker is at an all-time low. And the poor have suffered the most—for the economically weakest members of a community are also the politically weakest.

In this context, it is worth noting that a massive study in 1980 by the Joint Economic Committee of the United States Congress concluded that the key variable in wealth creation is the capital/labor ratio. The report further notes that this ratio has been falling in recent years, and is far below that of Japan. A crucial factor leading to this fall has been taxation policies to transfer wealth from the allegedly rich to the allegedly poor. (*Special Study on Economic Change*, volume 10, *Productivity: The Foundation of Growth* [Washington D.C.: Government Printing Office, 1980])

Third, wealth transfers have created "poverty traps" for the poorest. A family on welfare in Australia receives approximately $230 a week in money and in kind. (The Australian dollar is worth about 70 U.S. cents.) Accepting a part-time job at less than $230 actually results in a *decrease* in family income. Even accepting a job at a wage above $230 a week may make little economic sense. A person accepts a job at, say, $250 per week. He or she works forty hours simply to acquire $20—the difference between the wage and the welfare payments received if not working. The disincentives to productive enterprise are there—and they are working very well.

Fourth, the bureaucracy and veritable army of professional welfare workers presiding over our welfare state continue to grow, and are absorbing resources at an alarming rate. Indeed, if one calculates the total monies devoted to Australia's "war against poverty" and divides that sum by the number of people below the so-called "poverty line," one comes up with a wealth transfer of some $30,000 (Australian dollars) per poor person. Clearly, the poor do not receive that money. It goes essentially to the middle-class overseers of the system.

Many other factors could be cited in the worldwide move toward more market-oriented economies. I am convinced, however, that one critical factor has been all but missing, and almost entirely overlooked.

Those who, from the sixteenth century onwards, defended the free market in a free society, defended the market not simply because it led to material abundance, but because it rested firmly upon the liberty of all men and women peacefully to exercise their skills as they saw fit. What mattered was that people were free to dream their own dreams and strive to make these dreams come true. That such a social order led to unprecedented material abundance, witnessing the conquest of the dread specters of famine and destitution, was a staggering bonus.

I rejoice that economic reality has forced socialists in Australia and elsewhere to look with new openness at a market economy. Yet I am convinced that until there is a fervent commitment to the freedom the market order enshrines, our liberty—and the abundance we dare not take for granted—are tenuously grounded at best.

Mugged by Reality

To be mugged by economic reality—to discover that it is impossible efficiently to coordinate a people's productive activities by political decrees and a master plan—is one matter. To embrace the liberty of all men and women to formulate their own visions of the good life and to pursue those visions is an entirely different matter.

What the authoritarians want is economic efficiency. The have belatedly realized that nonexistent goods and services cannot be redistributed, and that a concentration upon wealth distribution and an indifference to wealth creation ill serves their vision of an allegedly just society.

Yet they still cling to the belief that a just society would display a pattern of wealth distribution that they have coercively imposed. They still embrace a disastrous distinction drawn by John Stuart Mill, that the productive capacity of the market, and the allocation of goods and services effected by the market, can be distinguished. Hence the ongoing search for that will-o'-the-wisp, the "neutral" tax, and a level of taxation that will simultaneously maximize taxation revenues without grossly modifying the behavior of productive individuals.

The crucial point is that the new socialists

are not committed to individual liberty and to private property rights as a necessary condition for the realization of that liberty. Indeed, it is more than conceivable that an economically "efficient" new-style socialism may more successfully fetter liberty than the notoriously inefficient, centrally planned socialist states of yesteryear.

Perhaps the most important moral to be drawn is that lovers of liberty must get their priorities right. Admittedly the market works, making material abundance a reality. Yet our primary defense of the market must be that only a market economy takes seriously the liberty of all men and women to dream their own dreams and peacefully to strive to make those dreams a reality.

When the focus moves from principle to pragmatism, from the moral rightness of the free market to the economic efficiency of the market, trade-offs between liberty and material abundance are to be expected. The moment such trade-offs in principle are allowed, they are destined to become realities. With them, however, comes the fading of the dream that matters most: the dream of a world in which no person is a pawn to be manipulated by another, and in which talk of the dignity of all people—a dignity rooted and grounded in the equal liberty of all—is more than empty rhetoric. □

Howard Dickman's *Industrial Democracy in America*

by Robert James Bidinotto

Of the enduring myths of economic history, few have hung on as tenaciously as the necessity and desirability of labor unions. Consider a recent editorial in my hometown newspaper, typical of the conventional wisdom:

"While unions today have a somewhat tarnished reputation, most historians generally concede that they played a key role in American economic and social advancement. Unions fought for higher wages and improved benefits for workers, allowing them to participate in the American dream. More money also meant workers could purchase more goods, fueling a consumer economy.

"Without unions and their system of collective bargaining, the U.S. could have lapsed into labor chaos and class warfare. These conditions in other countries led to the establishment of communist-inspired revolutions." (*The New Castle* (Pa.) *News,* August 14, 1987)

The editorial is correct about one thing. Today, there is general agreement (even from many on the political right) that, while unions may be too powerful, back in the days of "total laissez faire" they were a necessary counterweight to the unchecked power of "robber baron" employers. Unions are widely credited with raising the standard of living for millions of workers; with introducing democracy into the workplace; with protecting helpless laborers from being devoured by rapacious businessmen and blind market forces.

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Until now, there has been scant literature presenting a systematic, comprehensive challenge to these claims. But some years ago, eminent labor economist Sylvester Petro suggested a project to Howard Dickman. American trade unionism—especially its economic and intellectual rationales—deserved a dissection comparable to Ludwig von Mises' analysis in *Socialism.*

What were the ideas, the intellectual influences, that shaped today's labor policies? What popular myths and misconceptions gave rise to those ideas? When did they begin—and where have they led us?

Petro obviously had great confidence in his young listener. Dr. Dickman was then only in his mid-twenties; and his specialty was corporate, not labor, history. But he had an impressive familiarity with the theory and history of the free society, and the diligent temperament of a true scholar. He accepted the commission and went to work.

It would be ten years before the results of his labors were published. Now, readers can see for themselves that Petro's trust was not misplaced, with the appearance of *Industrial Democracy in America: Ideological Origins of National Labor Relations Policy* (La Salle, Illinois: Open Court, 1987, $32.95 cloth, $16.95 paper).

Dickman's book is a true landmark—a grand synthesis of history and analysis, an extraordinary *intellectual* account of trade unionism and collective bargaining. In its breathtaking scholarship alone, it rivals or surpasses

such standard works as Milton Derber's *The American Idea of Industrial Democracy* and such impressive general intellectual surveys as Sidney Fine's *Laissez Faire and the General Welfare State* or Arthur Ekirch's *Decline of American Liberalism*. And among the distinguished works written by pro-capitalist scholars, it compares with Dominick Armentano's *Antitrust and Monopoly*, Robert Hessen's *In Defense of the Corporation*, and Thomas Sowell's *Marxism*—except that it is far more ambitious, in aims and execution.

Building on the premise that *ideas* are the tidal forces underlying the course of events, the author explicitly avoids a mere "blow-by-blow history of the organized labor movement in America." Rather, he examines the pedigree of "industrial democracy" as a concept, focusing on the thinkers and theories which made unions and strikes possible. Quoting Friedrich Hayek, Dickman makes clear that his aim is to examine ideas which "often have crept in almost unnoticed and have achieved their dominance without serious examination. . . ."

There are several things unique about Dickman's treatment of labor history. First, his own philosophical and economic framework is explicitly laissez-faire capitalism, building on the ideas of Ludwig von Mises, Ayn Rand, W. H. Hutt, Sylvester Petro, and Friedrich Hayek. This allows him to place labor relations policies within the much broader context of the general rise of anti-capitalistic, anti-competitive doctrines and institutions. And unlike others who have plowed the same field, Dickman begins not in Civil War America, but as far back as fourteenth-century Europe, "in order to track down the intellectual sources of industrial democratic thought to their wellsprings."

From this unusual theoretical and historical vantage point, *Industrial Democracy in America* offers withering refutations of the historic, empirical, moral, legal, and economic arguments for compulsory collective bargaining. The result is a comprehensive case against coercive unionism unprecedented in scope, rigor, and persuasiveness.

For example, Dickman challenges the historical claims typified by the newspaper editorial cited earlier. As he summarized for this writer: "It is not true that unions were indispensable, that without unions workers would never rise. It is not true in history that most industrial violence was the fault of employers. And it is not true that unions were fighting for the working class." To refute these contentions, he traces the history of unions back to the medieval guild system.

The arguments offered for medieval guilds were strikingly similar to those put forth today for labor unions. "The guild monopoly was rationalized as necessary to protect the unsuspecting public from shoddy goods and unscrupulous artisans, on the theory that unrestricted competition would force producers and traders to cut corners to seize one another's business and exploit the hapless consumer," Dickman observes. "Guilds also existed to protect the social and economic status of merchants and craftsmen—probably their true *raison d' être*. In a society which valued security over liberty, the guildsmen were entitled to a customary, secure position in the social order, *a property in their job or way of life*."

"Owning" One's Job

This premise of a property right to one's occupation led inevitably to hostility toward free market competition, and ultimately to violence. Dickman cites accounts of fourteenth-century merchants waylaid for underselling competitors; of guild members hiring thugs to murder non-members who refused to be bound by guild rates; of frequent "bloody battles for the monopoly of work in a particular town," as one historian put it. The premise of a proprietary interest in one's job also led to the rewriting of history. Employers are typically portrayed as *initiating* industrial violence by depriving workers of their "rightful" jobs or wages while workers merely "fought back" for what was "theirs."

Besides corrupt "rights" theories, economic arguments were advanced to buttress the pro-union position. There was the argument (endorsed by Adam Smith) that workers must be at a disadvantage when bargaining with employers; that labor was the cause and measure of all economic value (Smith's "labor theory of value"); that laborers should get "the full

product of their labor"; that business recessions occur when workers are not compensated enough to "buy back what they produce"; etc.

Dickman raises and challenges each of these contentions on economic grounds, displaying a formidable grasp of free market theory. Take just one example—the notion of the "competitive disadvantage" of workers bargaining with employers.

This remains a central pillar of the case for labor unions. Even Adam Smith argued that it "is not . . . difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms." While in "the long-run the workman may be as necessary to his master as his master is to him, . . . the necessity is not so immediate." Dickman observes that such passages by capitalism's founding father "constituted an important legacy to the radical socialist and syndicalist critics of capitalism—who purported to demonstrate that employers kept wages at subsistence. . . ."

But are workers, in fact, at a true disadvantage? Due to the mobility of capital, Dickman notes, "an above-normal profit *due to a below-normal wage rate* creates a competitive imbalance which employers will exploit by bidding wages up." He quotes economist J. R. McCulloch, who pointed out that "a discrepancy of this kind could not be of long continuance. Additional capital would immediately begin to be attracted to the department where wages were low and profits high; and its owners would be obliged, in order to obtain labourers, to offer them higher wages. It is clear therefore, that if wages be unduly reduced in any branch of industry, they will be raised to their proper level without any effort on the part of the workmen, by the competition of the capitalists."

Dickman also rigorously examines the even more basic collectivist moral premises upon which such economic theories frequently rest. He points out, for example, that Adam Smith's well-known advocacy of self-interest, natural rights, and laissez faire was qualified and ambiguous; that Smith himself embodied the conflict between the premises of individual rights and social utilitarianism.

"The wise and virtuous man," wrote Smith, "is at all times willing that his own private interest should be sacrificed to the public interest of his own particular order or society . . . [and] that the interest of this order or society should be sacrificed to the greater interest of the state or sovereignty of which it is only a subordinate part . . . [and] that all those inferior interests should be sacrificed to the greater interest of the universe. . . ."

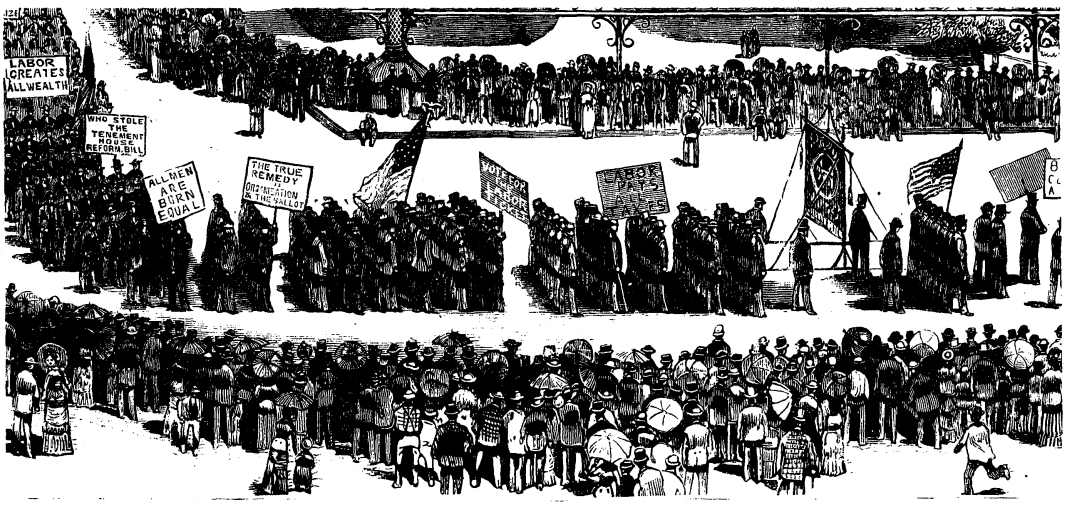
Similarly, John Stuart Mill's commitment to individual rights had a utilitarian escape clause. "All persons," said Mill, "are deemed to have a *right* to equality of treatment, except when some recognised social expediency requires the reverse."

It is impossible to discern any basic moral distinction between these two statements, and such anti-individualistic slogans as, "Ask not what your country can do for you; ask what you can do for your country"—or, "From each according to his ability, to each according to his needs." Because such collectivist philosophical premises were shared even by capitalism's most prominent defenders, they have remained largely unchallenged to this day. Dickman painstakingly isolates and dissects each of these in turn, as he traces their historical progression through academia, popular opinion and, eventually, into the law itself.

Of course, these isolated empirical, economic, and philosophical premises slowly congealed into full-blown theories, which Dickman broadly categorizes as "socialism" and "pluralism." The heart of the book traces the origins, implications, and consequences of these two schools, both of which profoundly shaped the American union movement.

Socialism and Pluralism

These competing collectivist theories proposed differing forms of industrial organization. Under socialism, all the means of production would be under the *exclusive* control of society, via the central government. Most American unionists, such as Samuel Gompers, did not buy the socialist call for abolition of private property; they feared (correctly, as modern history has shown) that the socialist state can be as repressive of labor as of business. However, they did swallow much of the



A labor demonstration in New York City's Union Square, 1882

socialist critique of the competitive marketplace, particularly socialist theories of unemployment and class conflict, and its moral attack on the profit motive.

Competing with the socialists were the so-called pluralists, who were equally hostile to individual rights, but were suspicious of centralized state power. Their solution was to favor the "rights" of *groups*. "Pluralism . . . was a vision of industrial democracy that amounted to what we might dub 'private government'—to a system in which the state would delegate to private social groups the traditionally sovereign legislative power to make rules for all individuals similarly situated in the economy—rules that overrode their contractual liberty," Dickman explains.

Pluralism cut across the left-right spectrum. In its right-wing, or corporativist form, society "would be reorganized into compulsory economic groups that would conduct economic affairs under the supervision of the state—that is, some kind of tripartite entente of government, business, and labor unions." (This, of course, was the form of collectivism that eventually led to fascism, and to modern industrial policy proposals.) "On the left, pluralism sought to eliminate the capitalist class and parcel out control of the economy between guilds or syndicates of workers and the state." (This syndicalist or guild socialist approach led to the contemporary movement for "decentralized, participatory democracy," in both the economy and society.)

One of the book's mere peripheral triumphs is its unmasking the facade of collectivist benevolence. Before the advent of modern public relations techniques, socialists and syndicalists were more forthcoming about their nature and aims.

Thus early German socialist Johann Gottlieb Fichte spelled out the state's ascetic expectations of the individual. "He who thinks *at all* of his own person and personal gratification, and desires any kind of life or being, or any joy of life, except *in* the Race and *for* the Race," he wrote, is "at bottom, only a mean, base, and therefore unhappy man."

French syndicalist Louis Blanc added: "If you are twice as strong as your neighbor it is a proof that nature has destined you to bear a double burden. . . . Weakness is the creditor of strength; ignorance of learning." (Today, John Rawls says the same things, much more opaquely.)

Nor were such sentiments foreign to our shores. American socialist Edward Bellamy, in his famous utopian novel *Looking Backward*, proposed dealing decisively with any laborer shirking his work duties: ". . . the discipline of the industrial army is far too strict to allow anything whatever of the sort. A man able to do

duty, and persistently refusing, is sentenced to solitary imprisonment on bread and water till he consents."

These few samples from among many Dickman has unearthed suggest something of the animating spirit of modern collectivism, of which the labor movement has played a key part. It is a measure of the richness of his scholarship that these quotations are drawn not from the text, but from his exhaustively detailed footnotes, which are an education in themselves.

An Anti-Empirical Approach

Dickman's methodological approach is as refreshingly unfashionable as are his conclusions. Because he takes ideas seriously, his approach is strongly anti-empirical—if we take "empirical" to mean dwelling on the concrete details of historical events. But if "empiricism" is simply taken to mean exhaustive scholarship, no one can fault him on that score.

Inevitably, his deliberate decision not to wallow in journalistic minutia affects the narrative, sometimes in startling ways. For instance, the book concludes with the effects of the National Labor Relations Act (Wagner Act) of 1935, essentially ignoring subsequent developments. That is because Dickman regards the Wagner Act as an ideological "watershed in American life," which not only "drastically altered the legal framework of the market economy in America," but also "transformed the very meaning of unionism and collective bargaining as they have hitherto been known."

Later efforts to mitigate its onerous consequences—e. g., the Taft-Hartley Act (1947) and the Landrum-Griffin Act (1959)— were largely cosmetic, he maintains. The ideological war which he chronicles really ended with Wagner. It is that law's basic premises which still dominate conventional thinking on labor unions, and have a continuing impact in such areas as civil rights policies and affirmative action regulations governing the workplace.

The decision not to bring the account "up to date" then, is in keeping with his thematic intent, his focus on ideas—even though it is a decision which more conventional empiricists may criticize. But in any event, Dickman succeeds brilliantly in showing how abstract theories become embodied in the concrete reality of human actions, institutions and, eventually, laws. To supplement his analysis, he appends the text of thirteen pivotal pieces of Western labor legislation, from the Ordinance of Labourers of 1349, to the Wagner Act of 1935. (The Fascist Labor Charter of 1927 is also reprinted, for its unnerving similarities to American labor legislation.) The reader can see for himself the ultimate destination of "mere" theories.

Free market advocates have always been long on theory, but too often short on scholarship. Dickman's formidable work (complete with 158 pages of appendices, footnotes, and index) shows the powerful persuasiveness of a union of the two approaches. *Industrial Democracy in America* is a revolutionary contribution to the literature of industrial relations. Its long-term effects cannot yet be gauged; but for our time, Howard Dickman has provided scholars and thinking laymen with a brilliant interpretive alternative to popular interventionist mythology. And he has exposed, with thundering finality, the fascistic portents inherent in "our quasi-syndicalist system of industrial democracy." □

A REVIEWER'S NOTEBOOK

Out of the Poverty Trap

by John Chamberlain

In their *Out of the Poverty Trap: A Conservative Strategy for Welfare Reform* (New York: Free Press, 264 pp., $17.95), Stuart Butler of The Heritage Foundation and Anna Kondratas of the Department of Agriculture's Food and Nutrition Service have a go at remedying what they perceive as the deficiencies of Charles Murray's epochal *Losing Ground.*

It is not that Butler and Kondratas disagree with Murray's analysis of the perverse effects of Lyndon Johnson's efforts to create a Great Society in which poverty would be abolished forever. The Murray statistics are irrefutable. Aid to Families with Dependent Children had actually broken up families. What had happened was that the man of the house would disappear so that his woman could qualify for government money for her children. Bill Moyers, an LBJ man, proved this for black families in a notable TV dramatization. But the Moyers' account went for white families as well.

Butler and Kondratas's own summary of the situation might have come directly from Murray's study. "Whether or not the system's financial incentives encourage dependency," they write, "the 'rights' view of welfare, whatever its humane intent, would probably have been enough by itself to undermine the War on Poverty. The structure of welfare eligibility and incentives has merely aggravated the problem. Assistance is based on need, rarely linked to efforts at self-improvement. Failure is rewarded, and 'deficiencies' are the key to one's well-being. When an unmarried mother shuns the support of her family and home, she is more deficient and so receives more help. If the father of her child would rather live off her than provide for her, so be it, welfare checks will not stop arriving. If he marries her and gets a job reflecting whatever skills he may have, the assistance will be cut, of course."

Most conservatives would presumably say that the Welfare State "entitlements" philosophy cannot be continued forever. Paying for it requires an economy-wrecking combination of taxation and inflation. Nevertheless Butler and Kondratas commend Lyndon Johnson for asking all the right questions. They think the American people, out of the goodness of their hearts, will insist on continuing entitlements until some way is found to make them less necessary.

Butler and Kondratas say they have no stomach for charging machine guns. What they advocate is a strategy of building small coalitions in favor of reform while eroding the power of those who would resist it. They talk about giving the poor the resources and responsibility for making their own choices in housing, child care, education, and other things, much as Margaret Thatcher has done in Britain.

In a succinct paragraph Butler and Kondratas specify "ideas like public housing tenant management, where the residents call the shots. Ideas like education vouchers so that poor families no longer have to put up with schools that seem to be run in the interests of the teachers' unions, not the children. Ideas like switching service contracts from outsiders to groups from within the community, who are more in tune with community needs. Ideas like changing day care rules so that Mrs. Smith is no longer a law-breaker if she looks after the kids of mothers who want to work."

Workfare

The idea of workfare is now stirring in various stages. Butler and Kondratas approve, but they realize it will cost money. They are not against measures that might be considered harsh, such as compelling teenagers to remain in their parents' homes with illegitimate children until the fathers can be located.

"Efforts to step up the collection of child support payments from absent fathers," Butler and Kondratas write, "are an appropriate and long overdue step toward encouraging parental responsibility. In the case of unwed mothers, especially teenage mothers, enforcing paternal responsibility is more problematic. Yet we have an obligation, for the child's sake, to attempt to enforce it. There is no reason why the new wave of workfare reforms should not include job clubs, mandatory job search, and fathering courses for unemployed fathers of illegitimate children. Whether or not they 'worked' initially, society would be sending a firm message to tell those parents what is expected. Government should not allow children to be held hostage so that parents can have their chosen lifestyles financed at public expense. . . . Both sets of grandparents of illegitimate children born to minors should be held legally responsible for supporting their grandchildren."

Since delinquent fathers are so adept at fading into the woodwork, it will surely be a long time before much can be done about them. Butler and Kondratas are more convincing when they talk about such things as the growing momentum for tenant management in public housing.

"A few years ago," they say, "tenant management was a mildly interesting and controversial curiosity. Today tenant managers are regularly featured in newspaper articles, in national news magazines, and at congressional hearings. The reason? The Washington-based National Center for Neighborhood Enterprise started to work closely with a number of management groups. Reporters eager for a good story were directed to showcase projects by the National Center's president, Robert Woodson."

Robert Woodson is apparently somebody with whom to conjure. Together with Kimi Gray, he has promoted the Washington Kenilworth Tenant Managed Project. A study of this project by Coopers and Lybrand has found enormous cost savings, service improvements, and job creation attributable to resident control.

The approach of Butler and Kondratas won't satisfy those conservatives or libertarians who want to get rid of the whole rigmarole of food stamps and the rest of the entitlements programs. But Butler and Kondratas are obviously right when they say we are a nation of altruists willing to dally with state compulsions. Ayn Rand has failed to convert enough people. The mitigating approach may be the best that can be managed until the ravages of what has been called the "malarial economy" have convinced enough people at the grassroots that something more fundamental is required. □

HAYEK ON LIBERTY
by John Gray
New York: Basil Blackwell • 1986 • 270 pp. • $12.95 paperback

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Reviewed by Richard M. Ebeling

In the 1930s Friedrich A. Hayek was recognized as one of the leading opponents of the emerging Keynesian Revolution in economic policy. In the 1940s he was equally recognized as one of the most articulate and incisive critics of socialism and government central planning. But the 1950s and 1960s were the intellectual highwater marks of both Keynesianism and socialism, and Hayek was "forgotten."

By the 1970s, however, Keynesian economics and socialism were in retreat and their demise was symbolized by the 1974 awarding of the Nobel Prize in Economics to Professor Hayek. Since then interest has reawakened in his earlier writings, he has published several important new works, and a number of volumes have appeared analyzing his contributions to the various social sciences.

One of the best of these critical evaluations is John Gray's *Hayek on Liberty,* which recently has been published in a second, revised edition. Professor Gray's training is in philosophy, politics, and economics, and he brings these skills to bear in offering an integrated analysis of Hayek's ideas as a coherent system of thought.

The heart of Hayek's system, as Professor Gray emphasizes, is his view of man and the constraints on man's ability to know and understand the world in which he lives. Being one of the elements forming the world, man lacks a privileged position that would enable him to step "outside" and see objectively how reality and its "laws" all fit together. His knowledge of the natural and social world, as well as of himself, is, therefore, always limited, uncertain, and incomplete. There is always more to know than the human mind can ever hope to fully comprehend.

Professor Gray explains that this led Hayek to question those social theories that claimed that the order and patterns discernible in social and economic life were the result of overall planning and design. Rather, Hayek turned to and developed further the theories of Adam Smith and Carl Menger (the founder of the Austrian School of Economics) which explained how the social and economic order, that we take for granted and which enables a high degree of interpersonal coordination in human affairs, is the result of rational actions but has not been created out of intentional designs. Instead, much of what we refer to as the "social order" emerged, evolved, and has taken shape out of the interactions of a multitude of individuals pursuing their respective self-interests. And the institutionalization and habituation of their actions in particular forms have generated a "spontaneous order" of human intercourse.

The realization that society and its structures are the cumulative, evolutionary product of many generations of people interacting and contributing some element and reinforcement to the social order made Hayek suspicious of those who proposed to redesign society "according to plan." Professor Gray lucidly explains and evaluates Hayek's writings on the origin and purpose of law, the limits and dangers of interventionist and socialist economic policies, and the disastrous consequences of government management of money in the form of the business cycle.

Finally, Professor Gray contrasts Hayek's ideas with those of John Stuart Mill, Herbert Spencer, Karl Popper, and Milton Friedman. This leads Gray to his own critical evaluation of Hayek's system. Here he shows himself to be a sympathetic critic. He believes that Hayek has seen and explained essential aspects of a successful theory of social and economic order. Yet, he says, Hayek fails to "ground" his system on any explicit moral principles, other than that a spontaneous order is more natural than any attempted created one and, therefore, a spontaneous order is "good" and superior. And, second, Professor Gray criticizes some of Hayek's writings where the argument seems to imply that any social order that has spontaneously evolved and "survived" has proven its worth. Gray correctly asks, I believe, why we should assume that evolutionary processes never lead to undesirable social outcomes or dead ends.

Professor Gray concludes with a suggestion that an improvement on Hayek's theory may possibly be found in the "Contractarian" approach of James Buchanan and the Public Choice theorists. This approach suggests that society be viewed as the result of a constitutional contract among free men, guided by rational choice, concerning the general "rules of the game" under which agents act and interact in society. But, as Gray admits, the tacit assumption is that the participants share a common belief in the Western individualist tradition. This still avoids, therefore, the crucial question: What are the moral and philosophical bases of individual liberty and rights, upon which a free society flourishes? □

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IDEAS ON LIBERTY

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THE FREEMAN
IDEAS ON LIBERTY

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Bruce M. Evans, chairman; Thomas C. Stevens, vice-chairman; Joseph E. Coberly, Jr., vice-president; Don L. Foote, secretary; Lovett C. Peters, treasurer.

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Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

The Enemy Within

"The fault, dear Brutus, is not in our stars, but in ourselves . . . ." These words, from *Julius Caesar,* describe a theme found in many of Shakespeare's plays—people being destroyed not by some enemy outside themselves but by an enemy within.

Those of us who value liberty frequently speak as though the enemies of liberty are found outside ourselves. And in truth there *are* such enemies—men and women committed to collectivism and busily working to impose it upon their fellows. Yet the significant enemy is to be found within ourselves. The name of that enemy, I suggest, is compromise.

Some measure of compromise may be inevitable. I avail myself of the services of a registered medical practitioner, even though, in Australia, I am thereby the "beneficiary" of partially socialized medicine. I attend the Australian Ballet, even though it is partly funded by money coercively extracted from my fellow citizens. In a fallen, statist world, pristine purity is seemingly impossible.

Yet for all this, many of us betray liberty by compromises we could avoid were we willing to pay the price. For example, we justify our acceptance of social security by claiming that we are merely getting back monies originally taken from us. In truth we are not! The money taken from us has already been spent. The money we receive is being taken from others, usually people younger than we are. In accepting that money, we are partners in plunder, sharing in the loot. More seriously, this compromise of principle reduces our stated support of liberty to mere words.

We do well to take seriously the activities of enemies of liberty. We delude ourselves, however, if we pretend that all these enemies are to be found outside us. The enemy we can most easily conquer is the enemy within, the spirit of compromise that makes our eloquent defenses of liberty ring strangely hollow.

George Meredith said it well:

In tragic life, God wot,
No villain need be! Passions spin the plot:
We are betrayed by what is false within.

—*John K. Williams*

Sign of the Times

Individuals and corporations are required by law to comply with all rules and regulations that have been published in the Federal Register. But just keeping up with the actions of the executive branch each day can easily amount to a full-time job. . . . Even the President of the United States isn't expected to keep track of the executive branch by reading the complete Federal Register every day.

—from an advertisement offering abstracts of the Federal Register.

The Freedom to Innovate

A centrally managed economy is a static economy. It produces what has previously been produced. It endeavors to satisfy only existing and well-recognized wants. If there had been universal socialism throughout the past century we would still be making buggywhips.

The free market permits one to try new ideas and either to succeed or fail. It is a risk that many will accept because there is ample reward for succeeding. The entrepreneur develops and offers to the free market a new product or service. He takes the risk of offering his creation to a non-existing or at least non-recognized market. He either succeeds or fails. The response of the free market determines which is the result. If he does succeed there is the chance that a new industry will emerge.

Centralized planning denies this opportunity to innovate. The citizens of such a government produce only what the central authority requires of them. The risk/reward factor is missing. The extent to which a socialist or communist society can expand is dependent on what it can copy from societies operating under the free market system.

—E. W. Colt

Stolen Jobs

What do a luxury hotel in Detroit, a 400-seat seafood restaurant in Baltimore, a Chrysler-Plymouth dealership in Salt Lake City, an amusement park in San Juan, Puerto Rico, and two Mitsubishi manufacturing facilities in Braselton, Georgia, have in common? They all are being built, in large part, with your tax dollars.

Over the next two years, reports the December 14, 1987, issue of *Insight,* the Department of Housing and Urban Development will ladle out $450 million in "Urban Development Action Grants." These grants, HUD officials tell us, are needed to create jobs.

But what about the jobs destroyed by these grants? Every dollar the government spends on a politically favored group is a dollar that you or I won't be able to spend or invest as we see fit. Rather than creating jobs, Urban Development Action Grants steal them from other parts of the country.

—BJS

Felix Morley Memorial Prizes

The Institute for Humane Studies has announced its 1988 Felix Morley Memorial writing competition.

The competition is designed to identify young writers who are interested in the free market philosophy. Applicants (college-age writers, but not necessarily enrolled in school) must submit an application, along with 3-5 clippings of editorials, op-eds, columns, essays, criticism, investigative pieces, or similar materials. Cash prizes will be awarded. The application deadline is June 15, 1988.

For more information, contact

Morley Prize Secretary
Institute for Humane Studies
George Mason University
4400 University Drive
Fairfax, VA 22030
(703) 323-1055

THE FREEMAN
IDEAS ON LIBERTY

Rewarding Uniformity

by Kenneth A. Bisson

"Because we had a 100 percent sign-up for fluoride treatments, we are going to make and share a pizza." I was dismayed to read that statement in my son's weekly parents letter from his third grade teacher. A push toward conformity had tested the integrity of a class of third graders.

What will a child do when facing a system designed to reward uniformity? Let's consider this question using the relatively innocuous case of offering a pizza lunch for 100 per cent sign-up for school fluoride. There will be two perspectives from which a student can consider a teacher's reward. Both perspectives provide a dismal view of rewarding uniformity.

We begin by assessing the effect of the school fluoride on each student's dental health. A decision to participate should depend on each student's unique circumstances regarding the fluoride content of his water, his toothpaste, and his preference for receiving any needed supplements from the family dentist or from the school.

As a family physician I guide parents making fluoride choices. In the well water across our county, natural levels of fluoride range from far below to far above the standard city water's controlled level of one part per million. I see children with fluorosis from excessive fluoride and children with caries which might have been avoided by increased fluoride use.

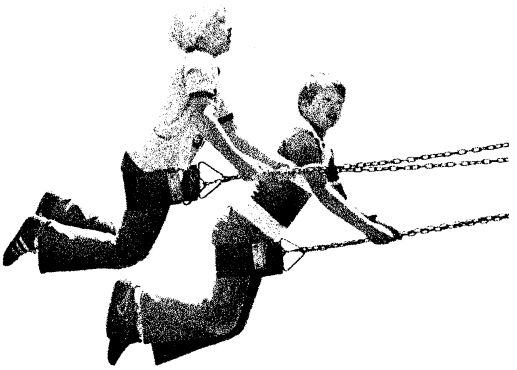
Thus, depending on his non-school fluoride use, a student may view the school's program from one of two perspectives: 1) I will benefit from participating in the school fluoride program, or 2) I will not benefit from participating in the school program. Even at this level of analysis the decision to reward 100 per cent participation begins to look questionable. A closer inspection of the effects on the individuals in either camp should lead to the rejection of reward systems that require uniformity.

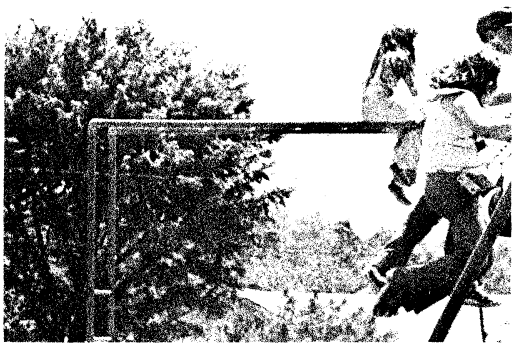
First consider the student who wants to participate and will benefit from additional fluoride treatments. His opportunity to receive pizza may be denied by the failure of another student to select the alternative preferred by the teacher. Will he feel motivated to urge classmates to select the preferred choice? What message is being given about individuals' thinking for themselves? Are these students being asked to "help" others to make the "right" choice? I believe this is unfortunately the case.

Although they may not be consciously aware of it, these students will be influenced by the many implications of this situation. The teacher's push toward conformity glorifies peer pressure. This is the same peer pressure we often ask our children to resist by urging them to "think for themselves."

Now let's consider the student risking harm from additional fluoride. For this student, a choice *not* to participate will preserve his teeth. Making that choice requires him to be true to himself. He thus demonstrates confidence in

Kenneth Bisson, M.D., has practiced family medicine in a rural Indiana community for the past eight years.





his ability to pursue his own values. By honestly doing so he maintains his integrity. Although his relationship with his teacher and classmates may unfortunately suffer, his self-esteem is not diminished by that choice.

Suppose however that this student fails to pursue his own values and instead sacrifices them in order to select the choice preferred by his teacher. Here the reward system is revealed to be a source of true misery. Of course, now everyone will get to enjoy a pizza lunch. But in abandoning his own values, this student is passing a judgment on himself that, after many repetitions, will cost him much more than unattractive teeth. When a child surrenders to pressure and denies the importance of his own values, he also surrenders his self-esteem.

Self-esteem is the reputation we acquire with ourselves. I believe that a primary challenge for parents and teachers, in working with children, is to enhance self-esteem. As a parent, I consider the encouragement of each of my children's self-esteem to be as important as providing food, clothing, and shelter. A high self-esteem is a major requirement of a fulfilling life. An individual with low self-esteem, by definition, will feel inadequate and unworthy of a happy, successful life. Such an individual will make choices that bring about a life that's as miserable as he believes he deserves.

I hope every parent and teacher will consider enhancing a child's self-esteem when choosing reward systems. Providing motivation in appropriate ways is not an easy task. As parents and teachers we must administer our power as an authority figure carefully, with deliberate forethought. Rather than reward uniformity, we can seize opportunities to celebrate individuality.

My focus on the individual in the above discussion does not imply that I undervalue the magnificent benefits of teamwork and group activities. Indeed, the best of achievements result from individuals working together! But it is *because* of individual differences that groups of individuals with differing strengths can produce more than can a group of clones. Imagine basketball teams comprised of all centers or all guards. Their performance would be reduced because of their uniformity. They would be as ineffective as would be a school full of only math teachers. Uniformity is a detriment to successful teamwork.

In conclusion, a reward system based on uniformity is unwise. Because of our valuable individual differences, it is uncommon for a single choice to be right for each of us. Even in that case where all individuals may actually benefit from selecting the same action, requiring uniformity denies the reward to all whenever one classmate chooses poorly. Usually such a reward system becomes an unreasonable test of integrity for the individuals who ought to make the unrewarded choice. Rewarding uniformity tempts these students to trade their self-esteem for the approval of their peers and teacher.

Encouraging individuals to be responsible for themselves results in a society of better individuals. Such individuals confidently exercise their decision-making capacity rather than defer to others. We can reward uniformity or we can encourage self-responsibility, competence, confidence, and integrity. The better choice is obvious. □

"Blat": Corruption in Eastern Europe

by Michael Brewer

When I first arrived in Yugoslavia as an exchange student, I knew three things: It was socialist, it was in Eastern Europe, and I would spend a year there. I also knew three words: *hvala, dovidjenja,* and *pivo*—"thank you," "good-bye," and "beer." I remember proudly pronouncing my first word in the language, *PECTOPAH,* only to find that it was in the Cyrillic alphabet and actually read "restoran," meaning "restaurant." Though I now blush at the thought of my naïvete, during my year-long stay in Yugoslavia I came to know the workings of a system misunderstood by most foreigners.

Ironically, one needs to know little Marxist-Leninist dogma to understand Eastern European economies. By contrast, most any capitalist is probably better suited to understand them . . . with the addition of two words—*blat* and *nalevo*.

The most sought-after commodity in Eastern Europe is *blat*. And *blat* is not Russian for caviar, nor Latvian for sable. *Blat* is Russian slang, and loosely means "influence or connection." The *blat* market is an underground where those with "connections" barter with others *ty mnye, ya tebye,* "you scratch my back and I'll scratch yours." It involves no money, only goods and favors.

Working *nalevo,* on the contrary, is often a substantial source of income for Soviet families. Soviets call it "creeping capitalism," and it literally means "on the left," but it translates more like, "on the side" or "under the table." In the Soviet Union, an additional income is vital to everyday existence. In Odessa, dubiously known as the "Chicago" of the USSR, there is a saying, "If you want revenge on a man, let him live on his salary." It's a terrible fate. No one can imagine it.[1]

The magnitude of *blat* and *nalevo* is not easily understood. They constitute much more than just a "black market," where denim-clad Soviet youth accost foreigners with offers of rubles for Levi's or thin western ties. "*Blat* is an essential lubricant of life."[2] Communism seeks utopia, and *blat* serves as the cushion between reality and ideology.

My host-father, a burly Slav with more than a hint of Gypsy blood and Gypsy guile, had an unusually ambiguous job title by Western standards.

"He is a *Direktor,*" my host-brother would tell me. Nothing could have been more vague. In Yugoslavia, *Direktor* is a title held by nearly everyone given a desk and a telephone.

He often took me to "work" with him. But we wouldn't go to his office. Instead, we frequented working-class taverns owned by friends of his. We would then sit at a smokey table with Gypsies—men with converging eyebrows and missing teeth—or those with briefcases and peppered gray hair, drink beer or *shlivovitz,* and listen to the loud folk music the band played. Through the din, my host-father would talk, argue, and smoke a lot of cigarettes. This always went on late into the night as we moved from restaurant to restaurant, and often became more like an unruly drinking bout as the night wore on.

These same restaurant owners, accordion players, circus owners, and other such folk often visited our house when my host-father failed to make his rounds. These visits were almost exclusively nocturnal, but because my host-brother and I slept in the nearest room, the conversations were always too loud to disregard.

One night an old salt with a wooden leg stopped in. He had a nasty habit of fiercely rapping his rings on the table when making a point. My host-mother was a strong woman, in mind as well as muscle, and any other man would have been quickly ushered out, but she did nothing. He brought with him a large sack filled with coffee and chocolate, both unattainable in Yugoslavia at that time, as well as sev-

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eral bottles of my host-father's favorite drink. The two ended up talking late into the night, sharing alternate drinks from a communal bottle, and seemed to come to some sort of agreement only hours before dawn.

The next day I began questioning my brother, and paying closer attention to my father's actions. I learned that my host-mother had once been a folk singer, and my father played the drums in the band. At this time, he had learned all the ins and outs of the music business. Then, when my host-mother gave up singing, he had landed a job with the government as an entertainment promoter.

The circus owners and musicians came asking for contracts to perform at certain locales, and the restaurant owners came asking for certain performers. My host-father was the middle man. He had influence, and he used it well. On several occasions when it was impossible to get coffee in the country, we were never without it. When most people had to wait five years for a telephone, ours took six weeks. My host-brother, who had passing grades only in English and physical education, was miraculously accepted into the best school in Belgrade. And, the last time I visited, my host father had somehow acquired (as gifts, of course) a new remote-control Sony television, two VCRs, and a video camera.

This is the *blat* market in Yugoslavia, a non-allied socialist country with equal billing in East and West.

Midway through my year in Yugoslavia, two Americans, a West German, and I planned to go to the Soviet Union with a Yugoslav tour group. Going with Yugoslavs, the Soviets would be more friendly toward us as "brothers in communism," and, most important, it was very cheap. I was very poor at the time and had just enough money for the tour price. So, upon reaching the border, I decided to sell my jeans.

Soon after we boarded a train to Kiev, on the Soviet-Hungarian border, a group of black-marketeers knocked on our compartment door. My friends and I bartered with them for a while, and I sold my jeans. We then asked them about themselves, and they ardently told us about their hometown near the Black Sea. I was surprised at how friendly and warm they were. I later encountered another type when I ran out of money in Leningrad and had to sell a swimming suit, some shorts, and a T-shirt that said "The Rolling Stones."

A young marketeer and I had come to an agreement on the sale. He counted out 2 twenty-five ruble notes, 5 fives, and 25 ones into his hand. 100 rubles—the arranged price. He then stopped. "Vait," he said, "I give you five more." And with the dexterity of a Gypsy card shark, he slid the big bills from the bottom of the stack with his other hand. He then reached into his pocket, deposited the big bills, took out a crisp five ruble note, and slapped it on top of the remaining 25 ones. Total—30 rubles. He grabbed the merchandise and disappeared. Unaware of what had taken place, I was left 70 rubles short (a little over 80 dollars), smiling like a man who had just beaten a pool hustler for five bucks, soon to lose his shirt.

Had I been on a train (as during my first sale) I could have tracked the thief down, since trains in the Soviet Union seldom stop between major cities. A city marketeer's disappearance, however, is faster than the Russian he speaks. A red fox in a green meadow must be cunning. And likewise, the "capitalist" under communism.

A Drop in the Ocean?

This is the extent of corruption seen by any foreigner visiting the Soviet Union: getting taken. I thought I had found a massive underground, but in reality, the black market is only a fraction of the whole.

Dr. Delbert Phillips, a professor of Russian at the University of Arizona who has been taking yearly excursions to the Soviet Union for over 20 years, agrees. In an interview (February 17, 1987) concerning corruption in the USSR, he told me, "the black market is only *kapya v morye,*" a drop in the ocean. It is an ocean that accounts for up to 40 per cent of the turnover of the entire economy.[3] *Blat* is half that ocean.

Blat ranges from finding two tickets to the sold-out hockey final, getting the freshest fruit, or buying a car in less than five years. Contrary to Western ways, however, menial jobs often have the most *blat*. Phillips, who knows the Soviet poet Yevgeny Yevtushenko, said that

"even the famous poet has to bow to the butcher for the best cuts of meat." Plumbers, auto mechanics, store clerks, and doormen, all have as much, if not more, *blat* than teachers, doctors, or engineers.

For example, Sasha, a book vendor and member of what Phillips calls his "Russian family," acquired a car in a little over six months by accumulating favors from the right people. When a sought-after book reached the shelves, he would take it off and save it for "friends" who wanted it. Six months and many books later it paid off.

Blat is an unspoken agreement, but "like Sicilian godfathers, Russians remember their obligations and know when it is appropriate to pay them."[4] For this reason, the system works.

The other half of the ocean is working *nalevo*.

An American student, who recently studied in the Soviet Union, told me about one of his experiences that typifies Soviet services.

In the communal bathroom in a dormitory, he noticed that one of the sinks had pulled out of the wall and was being supported by the pipes alone. He reported it to the dorm manager. Eager to please the American, the manager immediately sent for a repairman. In a week the repairman arrived and set the sink back in place with a few bolts drilled into the cinder block wall. The sink was heavy, however, and the cinder blocks crumbling. Two days later, the sink broke away a second time. The repairman returned, days later, and repaired it as he had before with the same result. It broke again. The embarrassed dorm manager then decided to call a *Maistor,* master of the trade. A week later the master came. He mixed up some quick-dry concrete and plastered the sink to the wall. The dorm manager was satisfied. Now, however, the sink weighed twice as much and soon pulled out from the wall even further. When the student left Moscow a month later, the sink was still broken.

Repair work of this caliber is scarce in the Soviet Union. It is usually worse. The demand for quick, quality service has opened up an enormous underground of working "on the side."

In a typical apartment service call, a repairman is first sent simply to diagnose the problem, be it the refrigerator, plumbing, heating, or whatnot. This diagnosis can take a number of weeks. Then a second person is dispatched to repair it—another few weeks. A month to repair a single problem. Often, however, the first worker to arrive will repair the problem on the spot for cash. This kind of work can more than double a repairman's monthly salary. It is exponentially more profitable to work privately. This goes for other professions as well.

For example, on a good day off, an auto mechanic can make half of his monthly salary doing private repairs. Construction workers often intentionally do bad work, and later come back privately to fix the job. Health care in the USSR is poor enough that doctors and dentists can make monumental sums on the side. And it is not uncommon for professors, who make less than bus drivers, to make six times their salaries tutoring the failing children of wealthy families.

In a speech to party members in Leningrad, Mikhail Gorbachev said, "Try to get your apartment repaired, you will definitely have to find a moonlighter . . . He will steal the materials he needs from a construction site." The theft of state-owned materials is not unusual. Most citizens don't see it as theft at all.

Michael Binyon, in his book, *Life in Russia,* provides a blatant, humorous example of theft from the State for personal gain.

> In August 1979 responsibility for the [railway] line from Kishinyov, the Moldavian capital, to the nearby port of Odessa in the Ukraine was divided [between the two republics]. On the first day of the new agreement, a [Moldavian] train set out from Kishinyov, crossed the border into the newly independent Odessa administrative zone and disappeared. . . . It turned out that the train had not just disappeared. It had been captured. The moment it crossed into the Odessa railway zone, the [Ukrainian] railway workers had seen their chance. They commandeered the engine and set it to work on their line. Now they could not only fulfill their plan, but overfulfill it and win a handsome bonus. It was not the only train that disappeared.[5]

The wild west still exists. It has only moved to the Ukraine and donned socialist clothing.

In October 1974, a commentary in *Komsomolskaya Pravda* dared to imply that the Soviet system is at fault for not meeting the basic needs of consumers. The government seems to understand that *nalevo* is necessary corruption. The importance of legalized private work illustrates this well.

The government allows every collective or state farmer a small plot of land to cultivate in his free time. It is interesting to compare data on this minimal, part-time, private farming to that of the *kalhozi,* or collective farms.

Although private plots make up only one per cent of farmed land, their produce makes up 26 per cent of the total value of the nation's farm output. They are roughly 40 times more efficient than collectives. According to the 1973 Soviet economic yearbook, in terms of value, private plots produced 62 per cent of the nation's potatoes, 32 per cent of other fruits and vegetables, 47 per cent of the eggs, and 34 per cent of the meat and milk.[6]

Obviously, the USSR would be unable to feed its people without the private sector. The Soviets need it, yet it is out of line with strict Soviet dogma. *Blat* and *nalevo* are the bastard children of the Soviet economy. They are publicly denied, but have flourished in the underground ever since their prohibition soon after the Revolution. And though still ideologically sidestepped, their economic benefits are becoming harder to ignore.

In June 1984, *Komsomolskaya Pravda* stated, "Our country values and supports personal farming for the general welfare, however, we cannot close our eyes to negative phenomena in the use of private plots—to the fact that this sector is sometimes transformed into a person's basic source of income, which leads to petty bourgeois mentality."

That was under Konstantin Chernenko, last in the line of Brezhnevian conservatives. Now, however, Gorbachev, a younger and more liberal leader, seems to see the necessity of limited private enterprises.

Recently, a report on McDonald's shown on Soviet television dared to suggest, "Maybe there is something we can learn from this." Several Pizza Hut restaurants are being constructed in Moscow and Leningrad. The Supreme Soviet, the USSR's national legislature, is currently experimenting on a small scale with a law that, much like China's new economic plan, would allow for "individual labor activity."[7] Individuals would be allowed to sell their services legally and also could band together in joint ventures such as small cafes or shops. Private hiring of subordinate employees would remain illegal, and excessive profits probably would be highly taxed, but, for the first time since Lenin's New Economic Policy ended in 1928, private industry would return to Russia.

Lenin's excuse was, "One step back to take two steps forward." Gorbachev seems to see that the "Revolution" has long since run out of steam, and, noting the Chinese communists' successes, looks to give it new life by adding capitalist incentives to socialist planning. But this is by no means the end of *blat.* As long as shortages of consumer goods exist, *blat* will continue to grease the economic machinery of Soviet and Eastern European society.

When my friends and I left the Soviet Union at a small border crossing near Hungary, I still had about 35 rubles (about 40 dollars) in my pocket. Our guide had told us that Soviet policy forbade the transfer of rubles out of the country. But I just couldn't bear giving them up. I stuffed them into a dirty sock and planted it in the middle of my duffel bag. If they wanted them that badly, they could have them. They didn't even stop our bus, and we drove past the rain-soaked sentries, on into Hungary. In retrospect, I'm not sure why I kept the rubles, risking a long and uncomfortable interrogation in a cold, wet room. They were basically worthless outside of the USSR and, as I had found, within as well. They were just paper. I guess I wanted to remember that. □

1. Hedrick Smith, *The Russians* (New York: Quadrangle/The New York Times Book Co., 1976), p. 89.
2. *Ibid.*, p. 88.
3. Jeff Trimble, "Earning a fast ruble; Pizza Hut's on the way as Soviets try free enterprise," *U.S. News and World Report,* November 24, 1986, p. 37.
4. Michael Binyon, *Life in Russia* (London: Hamish Hamilton, 1983), p. 255.
5. *Ibid.*, pp. 17-18.
6. Smith, p. 201.
7. Trimble, p. 36.

The Great Depression

by Hans F. Sennholz

Although the Great Depression engulfed the world economy more than 50 years ago, it lives on as a nightmare for individuals old enough to remember and as a frightening specter in the textbooks of our youth. Some 13 million Americans were unemployed, "not wanted" in the production process. One worker out of every four was walking the streets in want and despair. Thousands of banks, hundreds of thousands of businesses, and millions of farmers fell into bankruptcy or ceased operations entirely. Nearly everyone suffered painful losses of wealth and income.

Many Americans are convinced that the Great Depression reflected the breakdown of an old economic order built on unhampered markets, unbridled competition, speculation, property rights, and the profit motive. According to them, the Great Depression proved the inevitability of a new order built on government intervention, political and bureaucratic control, human rights, and government welfare. Such persons, under the influence of Keynes, blame businessmen for precipitating depressions by their selfish refusal to spend enough money to maintain or improve the people's purchasing power. This is why they advocate vast governmental expenditures and deficit spending—resulting in an age of money inflation and credit expansion.

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This article originally appeared in the April 1975 issue of The Freeman.

Classical economists learned a different lesson. In their view, the Great Depression consisted of four consecutive depressions rolled into one. The causes of each phase differed, but the consequences were all the same: business stagnation and unemployment.

The Business Cycle

The first phase was a period of boom and bust, like the business cycles that had plagued the American economy in 1819-20, 1839-43, 1857-60, 1873-78, 1893-97, and 1920-21. In each case, government had generated a boom through easy money and credit, which was soon followed by the inevitable bust.

The spectacular crash of 1929 followed five years of reckless credit expansion by the Federal Reserve System under the Coolidge Administration. In 1924, after a sharp decline in business, the Reserve banks suddenly created some $500 million in new credit, which led to a bank credit expansion of over $4 billion in less than one year. While the immediate effects of this new powerful expansion of the nation's money and credit were seemingly beneficial, initiating a new economic boom and effacing the 1924 decline, the ultimate outcome was most disastrous. It was the beginning of a monetary policy that led to the stock market crash in 1929 and the following depression. In fact, the expansion of Federal Reserve credit in 1924 constituted what Benjamin Anderson in his great treatise on recent economic history (*Economics and the Public Welfare,* D. Van Nos-

trand, 1949) called "the beginning of the New Deal."

The Federal Reserve credit expansion in 1924 also was designed to assist the Bank of England in its professed desire to maintain prewar exchange rates. The strong U.S. dollar and the weak British pound were to be readjusted to prewar conditions through a policy of inflation in the U.S. and deflation in Great Britain.

The Federal Reserve System launched a further burst of inflation in 1927, the result being that total currency outside banks plus demand and time deposits in the United States increased from $44.51 billion at the end of June, 1924, to $55.17 billion in 1929. The volume of farm and urban mortgages expanded from $16.8 billion in 1921 to $27.1 billion in 1929. Similar increases occurred in industrial, financial, and state and local government indebtedness. This expansion of money and credit was accompanied by rapidly rising real estate and stock prices. Prices for industrial securities, according to Standard & Poor's common stock index, rose from 59.4 in June of 1922 to 195.2 in September of 1929. Railroad stock climbed from 189.2 to 446.0, while public utilities rose from 82.0 to 375.1.

A Series of False Signals

The vast money and credit expansion by the Coolidge Administration made 1929 inevitable. Inflation and credit expansion always precipitate business maladjustments and malinvestments that must later be liquidated. The expansion artificially reduces and thus falsifies interest rates, and thereby misguides businessmen in their investment decisions. In the belief that declining rates indicate growing supplies of capital savings, they embark upon new production projects. The creation of money gives rise to an economic boom. It causes prices to rise, especially prices of capital goods used for business expansion. But these prices constitute business costs. They soar until business is no longer profitable, at which time the decline begins. In order to prolong the boom, the monetary authorities may continue to inject new money until finally frightened by the prospects of a runaway inflation. The boom that was built on the quicksand of inflation then comes to a sudden end.

The ensuing recession is a period of repair and readjustment. Prices and costs adjust anew to consumer choices and preferences. And above all, interest rates readjust to reflect once more the actual supply of and demand for genuine savings. Poor business investments are abandoned or written down. Business costs, especially labor costs, are reduced through greater labor productivity and managerial efficiency, until business can once more be profitably conducted, capital investments earn interest, and the market economy function smoothly again.

After an abortive attempt at stabilization in the first half of 1928, the Federal Reserve System finally abandoned its easy money policy at the beginning of 1929. It sold government securities and thereby halted the bank credit expansion. It raised its discount rate to 6 per cent in August, 1929. Time-money rates rose to 8 per cent, commercial paper rates to 6 per cent, and call rates to the panic figures of 15 per cent and 20 per cent. The American economy was beginning to readjust. In June, 1929, business activity began to recede. Commodity prices began their retreat in July.

The security market reached its high on September 19 and then, under the pressure of early selling, slowly began to decline. For five more weeks the public nevertheless bought heavily on the way down. More than 100 million shares

were traded at the New York Stock Exchange in September. Finally it dawned upon more and more stockholders that the trend had changed. Beginning with October 24, 1929, thousands stampeded to sell their holdings immediately and at any price. Avalanches of selling by the public swamped the ticker tape. Prices broke spectacularly.

Liquidation and Adjustment

The stock market break signaled the beginning of a readjustment long overdue. It should have been an orderly liquidation and adjustment followed by a normal revival. After all, the financial structure of business was very strong. Fixed costs were low as business had refunded a good many bond issues and had reduced debts to banks with the proceeds of the sale of stock. In the following months, most business earnings made a reasonable showing. Unemployment in 1930 averaged under 4 million, or 7.8 per cent of the labor force.

In modern terminology, the American economy of 1930 had fallen into a mild recession. In the absence of any new causes for depression, the following year should have brought recovery as in previous depressions. In 1921-22 the American economy recovered fully in less than a year. What, then, precipitated the abysmal collapse after 1929? What prevented the price and cost adjustments and thus led to the second phase of the Great Depression?

Disintegration of the World Economy

The Hoover Administration opposed any readjustment. Under the influence of "the new economics" of government planning, the President urged businessmen *not* to cut prices and reduce wages, but rather to increase capital outlay, wages, and other spending in order to maintain purchasing power. He embarked upon deficit spending and called upon municipalities to increase their borrowing for more public works. Through the Farm Board which Hoover had organized in the autumn of 1929, the federal government tried strenuously to uphold the prices of wheat, cotton, and other farm products. The GOP tradition was further invoked to curtail foreign imports.

The Hawley-Smoot Tariff Act of June, 1930, raised American tariffs to unprecedented levels, which practically closed our borders to foreign goods. According to most economic historians, this was the crowning folly of the whole period from 1920 to 1933 and the beginning of the real depression. "Once we raised our tariffs," wrote Benjamin Anderson, "an irresistible movement all over the world to raise tariffs and to erect other trade barriers, including quotas, began. Protectionism ran wild over the world. Markets were cut off. Trade lines were narrowed. Unemployment in the export industries all over the world grew with great rapidity. Farm prices in the United States dropped sharply through the whole of 1930, but the most rapid rate of decline came following the passage of the tariff bill." When President Hoover announced he would sign the bill into law, industrial stocks broke 20 points in one day. The stock market correctly anticipated the depression.

The protectionists have never learned that curtailment of imports inevitably hampers exports. Even if foreign countries do not immediately retaliate for trade restrictions injuring them, their foreign purchases are circumscribed by their ability to sell abroad. This is why the Hawley-Smoot Tariff Act which closed our borders to foreign products also closed foreign markets to our products. American exports fell from $5.5 billion in 1929 to $1.7 billion in 1932. American agriculture customarily had exported over 20 per cent of its wheat, 55 per cent of its cotton, 40 per cent of its tobacco and lard, and many other products. When international trade and commerce were disrupted, American farming collapsed. In fact, the rapidly growing trade restrictions, including tariffs, quotas, foreign exchange controls, and other devices were generating a world-wide depression.

Agricultural commodity prices, which had been well above the 1926 base of 100 before the crisis, dropped to a low of 47 in the summer of 1932. Such prices as $2.50 a hundredweight for hogs, $3.28 for beef cattle, and 32¢ a bushel for wheat plunged hundreds of thousands of farmers into bankruptcy. Farm mort-

gages were foreclosed until various states passed moratoria laws, thus shifting the bankruptcy to countless creditors.

Rural Banks in Trouble

The main creditors of American farmers were, of course, the rural banks. When agriculture collapsed, the banks closed their doors. Some 2,000 banks with deposit liabilities of over $1.5 billion, suspended operations between August, 1931, and February, 1932. Those banks that remained open were forced to curtail their operations sharply. They liquidated customers' loans on securities, contracted real estate loans, pressed for the payment of old loans, and refused to make new ones. Finally, they dumped their most marketable bond holdings on an already depressed market. The panic that had engulfed American agriculture also gripped the banking system and its millions of customers.

The American banking crisis was aggravated by a series of events involving Europe. When the world economy began to disintegrate and economic nationalism ran rampant, European debtor countries were cast in precarious payment situations. Austria and Germany ceased to make foreign payments and froze large English and American credits; when England finally suspended gold payments in September, 1931, the crisis spread to the U.S. The fall in foreign bond values set off a collapse of the general bond market, which hit American banks at their weakest point—their investment portfolios.

Nineteen thirty-one was a tragic year. The whole nation, in fact, the whole world, fell into the cataclysm of despair and depression. American unemployment jumped to more than 8 million and continued to rise. The Hoover Administration, summarily rejecting the thought that it had caused the disaster, labored diligently to place the blame on American businessmen and speculators. President Hoover called together the nation's industrial leaders and pledged them to adopt his program to maintain wage rates and expand construction. He sent a telegram to all the governors, urging cooperative expansion of all public works programs. He expanded Federal public works and granted subsidies to ship construction. And for the benefit of the suffering farmers, a host of Federal agencies embarked upon price stabilization policies that generated ever larger crops and surpluses which in turn depressed product prices even further. Economic conditions went from bad to worse and unemployment in 1932 averaged 12.4 million.

In this dark hour of human want and suffering, the federal government struck a final blow. The Revenue Act of 1932 doubled the income tax, the sharpest increase in the Federal tax burden in American history. Exemptions were lowered and "earned income credit" was eliminated. Normal tax rates were raised from a range of 1½ to 5 per cent to a range of 4 to 8 per cent, surtax rates from 20 per cent to a maximum of 55 per cent. Corporation tax rates were boosted from 12 per cent to 13¾ and 14½ per cent. Estate taxes were raised. Gift taxes were imposed with rates from ¾ to 33½ per cent. A 1¢ gasoline tax was imposed, a 3 per cent automobile tax, a telegraph and telephone tax, a 2¢ check tax, and many other excise taxes. And finally, postal rates were increased substantially.

When state and local governments faced shrinking revenues, they, too, joined the federal government in imposing new levies. The rate schedules of existing taxes on income and business were increased and new taxes imposed on business income, property, sales, tobacco, liquor, and other products.

Murray Rothbard, in his authoritative work on *America's Great Depression* (Van Nostrand, 1963), estimates that the fiscal burden of Federal, state, and local governments nearly doubled during the period, rising from 16 per cent of net private product to 29 per cent. This blow, alone, would bring any economy to its knees, and shatters the silly contention that the Great Depression was a consequence of economic freedom.

The NRA and the AAA

One of the great attributes of the private-property market system is its inherent ability to overcome almost any obstacle. Through price and cost readjustment, managerial efficiency and labor productivity, new savings and investments, the market economy tends to regain its

equilibrium and resume its service to consumers. It doubtless would have recovered in short order from the Hoover interventions had there been no further tampering.

However, when President Franklin Delano Roosevelt assumed the Presidency, he, too, fought the economy all the way. In his first 100 days, he swung hard at the profit order. Instead of clearing away the prosperity barriers erected by his predecessor, he built new ones of his own. He struck in every known way at the integrity of the U.S. dollar through quantitative increases and qualitative deterioration. He seized the people's gold holdings and subsequently devalued the dollar by 40 per cent.

With some third of industrial workers unemployed, President Roosevelt embarked upon sweeping industrial reorganization. He persuaded Congress to pass the National Industrial Recovery Act (NIRA), which set up the National Recovery Administration (NRA). Its purpose was to get business to regulate itself, ignoring the antitrust laws and developing fair codes of prices, wages, hours, and working conditions. The President's Re-employment Agreement called for a minimum wage of 40¢ an hour ($12 to $15 a week in smaller communities), a 35-hour work week for industrial workers and 40 hours for white-collar workers, and a ban on all youth labor.

This was a naïve attempt at "increasing purchasing power" by increasing payrolls. But, the immense increase in business costs through shorter hours and higher wage rates worked naturally as an *antirevival* measure. After passage of the Act, unemployment rose to nearly 13 million. The South, especially, suffered severely from the minimum wage provisions. The Act forced 500,000 Negroes out of work.

Nor did President Roosevelt ignore the disaster that had befallen American agriculture. He attacked the problem by passage of the Farm Relief and Inflation Act, popularly known as the First Agricultural Adjustment Act. The objective was to raise farm income by cutting the acreages planted or destroying the crops in the field, paying the farmers *not* to plant anything, and organizing marketing agreements to improve distribution. The program soon covered not only cotton, but also all basic cereal and meat production as well as principal cash crops. The expenses of the program were to be covered by a new "processing tax" levied on an already depressed industry.

NRA codes and AAA processing taxes came in July and August of 1933. Again, economic production, which had flurried briefly before the deadlines, sharply turned downward. The Federal Reserve business index dropped from 100 in July to 72 in November of 1933.

Pump-Priming Measures

When the economic planners saw their plans go wrong, they simply prescribed additional doses of Federal pump priming. In his January 1934 Budget Message, Mr. Roosevelt promised expenditures of $10 billion while revenues were at $3 billion. Yet, the economy failed to revive; the business index rose to 86 in May of 1934, and then turned down again to 71 by September. Furthermore, the spending program caused a panic in the bond market which cast new doubts on American money and banking.

Revenue legislation in 1933 sharply raised income tax rates in the higher brackets and imposed a 5 per cent withholding tax on corporate dividends. Tax rates were raised again in 1934. Federal estate taxes were brought to the highest levels in the world. In 1935, Federal estate and income taxes were raised once more, although the additional revenue yield was insignificant. The rates seemed clearly aimed at the redistribution of wealth.

According to Benjamin Anderson, "the impact of all these multitudinous measures—industrial, agricultural, financial, monetary and other—upon a bewildered industrial and financial community was extraordinarily heavy. We must add the effect of continuing disquieting utterances by the President. He had castigated the bankers in his inaugural speech. He had made a slurring comparison of British and American bankers in a speech in the summer of 1934. . . . That private enterprise could survive and rally in the midst of so great a disorder is an amazing demonstration of the vitality of private enterprise."

Then came relief from unexpected quarters. The "nine old men" of the Supreme Court, by unanimous decision, outlawed NRA in 1935 and AAA in 1936. The Court maintained that

the Federal legislative power had been unconstitutionally delegated and states' rights violated.

These two decisions removed some fearful handicaps under which the economy was laboring. NRA, in particular, was a nightmare with continuously changing rules and regulations by a host of government bureaus. Above all, voiding of the act immediately reduced labor costs and raised productivity as it permitted labor markets to adjust. The death of AAA reduced the tax burden of agriculture and halted the shocking destruction of crops. Unemployment began to decline. In 1935 it dropped to 9.5 million, or 18.4 per cent of the labor force, and in 1936 to only 7.6 million, or 14.5 per cent.

A New Deal for Labor

The third phase of the Great Depression was thus drawing to a close. But there was little time to rejoice, for the scene was being set for another collapse in 1937 and a lingering depression that lasted until the day of Pearl Harbor. More than 10 million Americans were unemployed in 1938, and more than 9 million in 1939.

The relief granted by the Supreme Court was merely temporary. The Washington planners could not leave the economy alone; they had to win the support of organized labor, which was vital for re-election.

The Wagner Act of July 5, 1935, earned the lasting gratitude of labor. This law revolutionized American labor relations. It took labor disputes out of the courts of law and brought them under a newly created Federal agency, the National Labor Relations Board, which became prosecutor, judge, and jury, all in one. Labor union sympathizers on the Board further perverted the law that already afforded legal immunities and privileges to labor unions. The U.S. thereby abandoned a great achievement of Western civilization, equality under the law.

The Wagner Act, or National Labor Relations Act, was passed in reaction to the Supreme Court's voiding of NRA and its labor codes. It aimed at crushing all employer resistance to labor unions. Anything an employer might do in self-defense became an "unfair labor practice" punishable by the Board. The law not only obliged employers to deal and bargain with the unions designated as the employees' representatives, later Board decisions also made it unlawful to resist the demands of labor union leaders.

Following the election of 1936, the labor unions began to make ample use of their new powers. Through threats, boycotts, strikes, seizures of plants, and outright violence committed in legal sanctity, they forced millions of workers into membership. Consequently, labor productivity declined and wages were forced upward. Labor strife and disturbance ran wild. Ugly sitdown strikes idled hundreds of plants. In the ensuing months economic activity began to decline and unemployment again rose above the ten million mark.

But the Wagner Act was not the only source of crisis in 1937. President Roosevelt's shocking attempt at packing the Supreme Court, had it been successful, would have subordinated the Judiciary to the Executive. In the U.S. Congress the President's power was unchallenged. Heavy Democratic majorities in both houses, perplexed and frightened by the Great Depression, blindly followed their leader. But when the President strove to assume control over the Judiciary, the American nation rallied against him, and he lost his first political fight in the halls of Congress.

There was also his attempt at controlling the stock market through an ever-increasing number of regulations and investigations by the Securities and Exchange Commission. "Insider" trading was barred, high and inflexible margin requirements imposed and short selling restricted, mainly to prevent repetition of the 1929 stock market crash. Nevertheless the market fell nearly 50 per cent from August of 1937 to March of 1938. The American economy again underwent dreadful punishment.

Other Taxes and Controls

Yet other factors contributed to this new and fastest slump in U.S. history. The Undistributed Profits Tax of 1936 struck a heavy blow at profits retained for use in business. Not content with destroying the wealth of the rich

through confiscatory income and estate taxation, the administration meant to force the distribution of corporate savings as dividends subject to the high income tax rates. Though the top rate finally imposed on undistributed profits was "only" 27 per cent, the new tax succeeded in diverting corporate savings from employment and production to dividend income.

Amidst the new stagnation and unemployment, the President and Congress adopted yet another dangerous piece of New Deal legislation: the Wages and Hours Act or Fair Labor Standards Act of 1938. The law raised minimum wages and reduced the work week in stages to 44, 42, and 40 hours. It provided for time-and-a-half pay for all work over 40 hours per week and regulated other labor conditions. Again, the federal government thus reduced labor productivity and increased labor costs—ample ground for further depression and unemployment.

Throughout this period, the federal government, through its monetary arm, the Federal Reserve System, endeavored to reinflate the economy. Monetary expansion from 1934 to 1941 reached astonishing proportions. The monetary gold of Europe sought refuge from the gathering clouds of political upheaval, boosting American bank reserves to unaccustomed levels. Reserve balances rose from $2.9 billion in January, 1934, to $14.4 billion in January of 1941. And with this growth of member bank reserves, interest rates declined to fantastically low levels. Commercial paper often yielded less than 1 per cent, bankers' acceptances from ⅛ per cent to ¼ per cent. Treasury bill rates fell to 1/10 of 1 percent and Treasury bonds to some 2 per cent. Call loans were pegged at 1 per cent and prime customers' loans at 1½ per cent. The money market was flooded and interest rates could hardly go lower.

Deep-Rooted Causes

The American economy simply could not recover from these successive onslaughts by first the Republican and then the Democratic administrations. Individual enterprise, the mainspring of unprecedented income and wealth, didn't have a chance.

The calamity of the Great Depression finally gave way to the holocaust of World War II. When more than 10 million able-bodied men had been drafted into the armed services, unemployment ceased to be an economic problem. And when the purchasing power of the dollar had been cut in half through vast budget deficits and currency inflation, American business managed to adjust to the oppressive costs of the Hoover-Roosevelt Deals. The radical inflation in fact reduced the real costs of labor and thus generated new employment in the postwar period.

Nothing would be more foolish than to single out the men who led us in those baleful years and condemn them for all the evil that befell us. The ultimate roots of the Great Depression were growing in the hearts and minds of the American people. It is true, they abhorred the painful symptoms of the great dilemma. But the large majority favored and voted for the very policies that made the disaster inevitable: inflation and credit expansion, protective tariffs, labor laws that raised wages and farm laws that raised prices, ever higher taxes on the rich and distribution of their wealth. The seeds for the Great Depression were sown by scholars and teachers during the 1920s and earlier when social and economic ideologies that were hostile toward our traditional order of private property and individual enterprise conquered our colleges and universities. The professors of earlier years were as guilty as the political leaders of the 1930s.

Social and economic decline is facilitated by moral decay. Surely, the Great Depression would be inconceivable without the growth of covetousness and envy of great personal wealth and income, the mounting desire for public assistance and favors. It would be inconceivable without an ominous decline of individual independence and self-reliance, and above all, the burning desire to be free from man's bondage and to be responsible to God alone.

Can it happen again? Inexorable economic law ascertains that it must happen again whenever we repeat the dreadful errors that generated the Great Depression. □

The Poor Among Us

by Ruth Burke

Not long ago, I was living in an ancient trailer on some land I was buying in a community near the Colorado River in Arizona.

Although I had a steady job, the pay wasn't fantastic. So I was living in a 1945-model trailer, lit only by a light bulb at the end of a long cord. My water didn't run, I did—for when I wanted it I carried a container across a field. My plumbing wasn't indoors, and the necessary house, as they used to put it, was across the field.

Needless to say, I didn't have air conditioning during the scorching desert summers, although I finally got a fan. But I bore the heat by closing the trailer up in the daytime and opening all the doors and windows at night. Hardships never bother me much, for I learned how to cope during the Depression.

Anyway, I had the pride of knowing that my six acres were going to be my stronghold in hard times. The land had plenty of water, being near the river, and the town was near enough that I could walk to it. I could see all the stars at night, hear the call of coyotes, and the peace and quiet were such that it seemed I was miles from civilization.

One day a friend called me at work and said that a family had come to town broke and were camping in their vehicle beside the river. Since the other transients in the area seemed to be taking an undue interest in the young girls of the family, she wondered if I could let them camp at my place over the upcoming holiday weekend. She told me that they had already been to the St. Vincent de Paul to get a food voucher, and on the next day that the welfare office opened, they planned to go and try to get a check and food stamps.

"Fine," I told her and asked that they meet me outside my job that evening, so I could guide them to my place.

If I had expected the Joads, I was in for a surprise. For they weren't driving a flivver with household possessions piled high and a goat boxed in on the running board, but rather an expensive, late-model van.

Well, I reasoned that many folks without a penny to their name were somehow able to drive new cars. So I introduced myself to this family, which consisted of a man, a teen-aged boy, two girls, one perhaps fourteen and one younger, and a baby.

I explained that we would have to drive a short distance out of town and offered to pay for some gas for the van if they needed it. They said that they thought they had enough to get that far and back to the welfare office when it opened the following Tuesday. And then I mentioned that my land was the site of a former junk yard—and that the previous owner hadn't finished removing all the cars—but that they must not let that disturb them.

They followed me out there and I told them where to park. Then I showed them where the water faucet was and said that the privy was behind some bushes.

"What's a privy?" the older girl asked.

Ruth Burke is a free-lance writer in Arizona.

I explained. "Gross!" she replied.

The man of the family explained that they had started from Florida with enough money, but on the way they had to pay for unexpected repairs on their van—but when their checks caught up with them they would be in good financial shape again.

We talked awhile and I pointed out my old trailer—which was on the other end of the property—hardly distinguishable from some of the junk, no doubt, to the casual observer. And then suddenly the older of the two girls spoke up and asked, "How can you live like this?"

For once I was speechless, but when I remembered that my old car and the trailer were paid for and that I didn't owe any debts except my property mortgage, I answered, "Very easily."

I retired to my trailer and the blanket of darkness swooped down on us and I went to bed—secure in my snug little world.

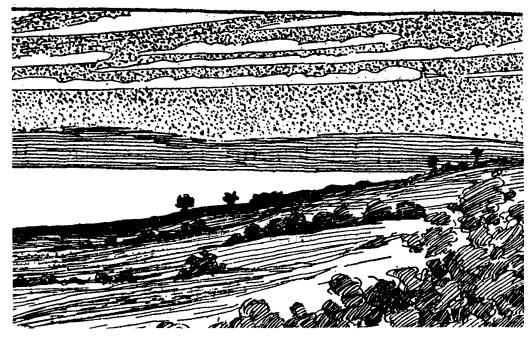
If I vaguely wondered how my guests were doing, I wasn't in doubt more than a few hours, for the sound of someone knocking at my door woke me up. I looked at the clock, which said it was 11:00 P.M., and went to open up.

It was the oldest girl again, the one who had questioned my lifestyle. And visibly agitated, she said, "I just came to tell you that we can't stand it out here any longer—and we're leaving." Then as she turned to go, she added, "but thanks anyway."

Soon there was the roar of a motor starting up and then I saw twin red pin points of light dimming and vanishing in the distance. And then I was alone with my thoughts, the wind, the coyotes, and the stars overhead.

For awhile I felt ashamed that I was too broke to help the poor (I may be broke, but I'm never poor, even if I don't have a single possession to my name) but then I wondered if the time had come when beggars *were* choosers. And I decided that maybe it had.

When I calmed down enough to think rationally, I decided that many of the current crop of



penniless wayfarers don't have the survival skills of the old Knights of the Road—and don't know that there is any other way to live than as a part of the post-World War II affluent society with all its assorted gadgetry.

For many years I've known that the so-called poor have many more worldly goods than I, and what is a poverty level for some isn't for me. In 1986 my income was 79 per cent under what the government says is the poverty line, but I wasn't particularly needy and had a few things that I consider luxuries (books, magazines, writing paper, stamps, etc.) so I guess the subjective view of one's status in life is quite different from an objective one.

While I made allowances that my unhappy guests were city people unused to the silence of the desert and country ways of doing things, I finally decided that the prevailing view of the down-and-outs is that people who give handouts to them better have something good to give, for no matter how needy, they don't want junk.

Oh yes, there's something more I'd better tell you. The following week, and for a few days after, I saw my visitors' van parked at the welfare office. I decided that it might not have been as easy for them to get welfare as they had thought. But later I met them in the store and they said that they had been placed in a trailer somewhere—presumably one that had running water and a toilet—where they wouldn't have to listen to coyote serenades in the stillness of the night. □

Man at His Best

by Robin Lampson

The willingness of people to help others who are suddenly overwhelmed by a great emergency or disaster is one of the more pleasing characteristics of human beings.

The most amazing instance of this which I can remember occurred right after the great earthquake of April 18, 1906, and the terrible fire in San Francisco that followed. The story I tell here is something I witnessed myself, and I have never come across anything other than the merest generalities about it in books or magazine articles I have read about that holocaust—although the newspapers no doubt reported details of it at the time.

I was a youngster just two-and-a-half months past the age of six that April morning, and nearing the completion of the first grade of grammar school. I woke to find my small bed dancing around the room, with my father holding on to the footboard. I cried out, "What are you pushing my bed around for, Pa?" I didn't realize that he was holding on to my bed so as to stay on his feet during the earthquake!

This was not in San Francisco, but in the small town of Geyserville, in upper Sonoma County, 75 miles north of the metropolis. The temblor did a great deal of damage in that area also, razing many buildings in Santa Rosa and Healdsburg, and leaving hardly a chimney standing in our small town.

Before my father let go of my bed we heard the sound of bricks falling on the roof. "There go the chimneys!" Dad commented forlornly.

It wasn't long before we learned we had lost the brick chimneys of both our kitchen range and living-room stove, and that most of our windows were broken. In addition, my mother lost more than half of her dishes, and she was further saddened because quite a number of cans and glass jars of home-canned fruit and vegetables had been shaken off of shelves and ruined.

My father—the town blacksmith—had to set up a camp stove in the backyard so my mother could cook breakfast. Fortunately, his smithy was at the very north end of the small business section of Geyserville, and his shop and our home and barn, chicken-house, windmill and water tank were all on a four-or-five acre "lot" that was pretty much like a small farm. We had a couple of cows, a few pigs, 40 or 50 chickens, an acre or so of various grapes, a dozen or more different kinds of fruit trees, several varieties of berry vines, and a vegetable garden that made excellent use of every remaining square foot of available ground.

That April morning ushered in a clear, warm spring day as well as an earthquake for us—and the quake did not disturb the flow of food from our cows and chickens and garden. After breakfast, I hurried downtown with a couple of my older brothers to see what had happened to the dozen or so business places of the village.

Nearly all the front windows of the stores were shattered, and all the glass lay in splinters on the sidewalks. But the real thrill came when we reached the town's lone candy store and soda fountain. The owner, named Elmer Nordyke, stood in the doorway sadly surveying the wreckage.

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Inside, the candy showcases were all overturned, and candy was strewn all over the floor, and also out on the sidewalk from the display behind the now completely shattered plate-glass front window. "Help yourselves, kids," said Mr. Nordyke, smiling rather sadly. (I hardly need add that no second invitation was necessary.)

Since the daily newspapers immediately stopped coming through from San Francisco, and long distance telephone service was still in its infancy, the wildest of rumors began circulating. But freight and passenger trains were still running in both directions on the Northwestern Pacific Railroad and the telegraph lines were still open—though in those days in that area the telegraph offices were all in railway stations. But the news which the wires brought to us from Sausalito, across the bay from San Francisco, was only of catastrophe so often told that there is no need for me to repeat it here.

A Desperate Need

A day or so later word began coming through by telegraph that food was desperately needed for the hungry, homeless tens of thousands of quake and fire victims in San Francisco. Then one morning, the daily northbound freight train from Sausalito shunted an empty boxcar onto a siding at the Geyserville depot.

The local depot agent of the Northwestern Pacific lost no time in spreading the appeal which he had received by telegraph. The railroad was leaving one or more empty boxcars at each of its stations along the entire route—and appealed to the people of each community to fill these cars with any food they could spare for San Francisco. The railroad, of course, was contributing the transportation.

The word got around very fast, and the appeal was nothing less than electrifying. Every farmer who came into town heard about it—and took pains to inform his neighbors on the way back home, and neighbors were asked to inform their neighbors farther on. The rural mail carrier, with his horse and buggy, stopping at every roadside mailbox, was also highly effective in spreading the message.

The town or community of Geyserville, with about forty homes around the small business section, in 1906 couldn't have had a total population of more than 400 if one included all the farms within a radius of four or five miles. Yet, within a couple of hours, men, women and children began coming to that boxcar with baskets and packages and armloads of food.

They brought loaves of homemade bread, mason jars of home-canned fruits and vegetables, sacks of potatoes, bags of dry beans, rice and sugar, and jars of fresh milk and newly churned butter. As the day wore on, people from the town and nearby farms began bringing in cooked chickens and roasts of beef, veal, pork, and lamb.

This is all the more remarkable when you bear in mind that there was not only no radio or television in those days, but also the telephone and automobile had not yet arrived in our small community. There were a few—very few—bicycles around, but otherwise everyone traveled either by horse or on "shanks' mare." Yet the appeal kept on spreading fast—for neighbor told neighbor.

Ours was a large family, with nine children, and each year my mother "put up" several hundred quarts of tomatoes, green beans, peas, apricots, cherries, peaches, pears and berries—in one and two-quart mason jars or in tin cans sealed on top with wax. In addition that amazing woman filled scores of glasses and jars of all sizes and shapes with jellies and jams. (In addition to the fruits and vegetables which we grew on our place, my father received various other produce, such as potatoes and pumpkins, squash and melons, raisins and dried prunes and other fruits, also turkeys and sides of veal, pork, and lamb, in exchange for horse-shoeing and other blacksmith work for farmers.)

Now in April, 1906, my parents decided to split the remainder of our winter supply of "canned" fruits and vegetables with the hungry people of San Francisco. But what my parents gave was only typical of the donation of practically every household in the community. And the storekeepers of the town also contributed from their shelves and storerooms. In addition, volunteer workers came to the boxcar and helped to pack the food in boxes, cartons, and crates; and a couple of carpenters, working with boards and nails donated by the local lum-

Refugees eating on Franklin Street, near Fulton Street, after the San Francisco earthquake, 1906.

THE BETTMANN ARCHIVE

beryard and hardware store, shored up the load inside the car so that the food would ride safely to Sausalito, where it would be ferried to San Francisco.

Before dark the first day the boxcar was nearly full, sealed by the station agent, and ready to roll. And that night the southbound freight train carried the car to its destination.

The next morning the northbound freight left another empty car on the siding—and the amazing spontaneous process of filling it began all over again. And from what I remember hearing at the time, the same sort of response was happening at all the other stations along the railroad.

The day of the earthquake my father immediately made temporary repairs to our kitchen chimney, using stove-pipe instead of brick, so that my mother could use our old-fashioned kitchen range. There was no "little old bakeshop" in the town, so housewives did all their own baking. That evening my mother did what many other housewives in the town were doing: she made up several large washpans full of fragrantly yeasty bread dough, which she "set to rise" overnight.

The next morning before dawn my father lit a good fire in the range, and soon my mother had two large bread pans, each with six large loaves, baking and filling the kitchen with their mouth-watering aroma. When these loaves came out of the oven, my mother laid them out to cool under clean white flour sacks made into dish towels—and immediately put another batch of 12 loaves into the oven.

That afternoon she wrapped each panful of six attached loaves in clean newspaper (wrapping paper was not plentiful in 1906) and tied it up with string from packages that had come from the stores. Then two of my older brothers, aged 8 and 10, and I felt quite proud when we were allowed to carry the packages down to the depot to be loaded into the boxcar.

(I see I have forgotten to mention that the town's small two-room schoolhouse—with two teachers for the 75 or 80 pupils in the eight

grades—was also damaged that April Wednesday morning by the earthquake, and carpenters and glaziers were called in to make repairs. So classes did not resume until the following Monday, and this extra school holiday only added zest to the excitement of us youngsters who were watching the relief food go into the boxcars.)

By this time the food emergency in San Francisco was pretty well known to all the people of the Russian River Valley—as well as to most of the rest of the civilized world. Some of the San Francisco newspapers, which had many subscribers in the Sonoma County, were now being printed in Oakland and were coming through by way of Vallejo and Sonoma; and the Santa Rosa dailies were also bringing in reports of the extent of the holocaust.

So it was that the farmers and their wives, even from the most distant farms in that section of the valley, brought in their contributions—more sacks of potatoes and dried fruits, plus hundreds of quarts of "canned" fruits and vegetables. Dressed and roasted chickens were hauled in by the dozens. Pigs, calves, and lambs were slaughtered and dressed—and added to the store in the boxcar. Ed Cook, my father's close friend who ran Geyserville's butcher shop (we didn't call it a meat market in those days), donated a quarter of beef or a dressed hog each day.

This went on for many days, with a new boxcar arriving empty in the morning and going south filled again at night. Just how long this continued I do not recall exactly, but I believe it was more than a week, probably 10 or 12 days—until word came that large shipments, even whole trainloads, of donated relief food and supplies from other states clear to the East Coast were beginning to arrive in San Francisco. Please remember that I was only six years old when all of this happened—and it never occurred to me to jot down any of it until over 60 years later. In fact, I feel that time has, if anything, only blurred my memory of what a remarkable and wonderful phenomenon my childish eyes were permitted to witness!

None of the people of our small community were rich. Some of them owned their farms or homes, but most of them lived "lives of quiet desperation," and never knowing what it was like to be without worry over bills and debts, rent and mortgages. (Our family was one of the latter.) All these people had to work, and work hard and constantly, to earn a living—and expected to do so to the end of their days. Yet practically every family unhesitatingly shared what it had with the disaster victims of San Francisco.

From 1906 to the present time I have never heard this story told, nor come across anything about it in print. It is most likely that other railroads and also shipping lines carried out programs of gathering and transporting food and supplies for the hungry and homeless in San Francisco. Likewise, I doubt very much if any community in California, or in neighboring states too for that matter, failed to send help in some form—money, food, clothing, bedding, etc.

But I saw with my own eyes what happened in one small farming community, and I knew that something similarly wonderful was happening in many neighboring communities. And I now realize that when I was very, very young—too young to be aware of it at the time—I was fortunate enough to have a good look at *man at his best.* □

Libertarian Sympathies: Heart and Mind

by Joseph S. Fulda

Two questions invariably asked of me by those unacquainted with libertarian thought and surprised at many of the arguments and observations I put forth are "Why are you so committed a libertarian?" and "What are some of the difficulties with the philosophy—where is it somewhat strained?"

This essay, then, is my attempt to answer these questions about the attractions and difficulties with the philosophy so many of us have embraced.

Libertarianism appeals to both heart and mind. For many of us, especially the young, libertarianism arises as a natural consequence of a free-spirited personality: yearning to enjoy life, with as few encumbrances as possible, and to answer to no one but ourselves and (for some of us) God.

For many of us, also, libertarianism arises from deep-seated philosophical convictions about the nature and dignity of man and the way the world works. These convictions are variations on three themes.

The first is the spiritual case for liberty: that men are naturally born with free will and that it is, therefore, both their right and their duty—their unique destiny—to use this God-given capacity to choose among alternatives, for good or for bad, for happiness or for unhappiness—provided, of course, that in so doing they in no way remove others' free will.

The second is the moral case for liberty: that the use of force, except in self-defense—individual or collective—is simply wrong. This understanding of the inviolable nature of the rights of man arises directly from a conception of his dignity.

The third is the empirical case for liberty: that a free society promises the greatest good of the greatest number, that freedom truly works. Unlike the spiritual and moral premises, which to many are self-evident, the way the marketplace works to our benefit is often subtle. It is, for example, not obvious that the benefits of productive advances are greatest for the poor,[1] that distribution-of-income figures do *not* show a permanent underclass in capitalist society,[2] that we benefit most from the liberty of *others* and in ways we can barely imagine,[3] that government programs are *necessarily* wasteful,[4] that the market is *self*-regulating if given the chance,[5] and that the beneficiaries of state action are so often visible and well-organized, while those who lose as a result of state action are either not visible or are so diffuse a group as to make it difficult and unprofitable to organize.[6]

Because of these and other subtleties, it is usually necessary for those who espouse the freedom philosophy to make a separate, empirical case against each existing or proposed government program or regulation. This can be not only exasperating, but also particularly difficult for functions government assumed long ago, because it is hard to know just how the market—coordinating the spontaneous responses of many millions of people—would today handle

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these functions. Thus a grounding in economic history, as well as in economic theory, is needed to provide much of the empirical case for private schools, privately owned streets, voluntary charity and relief, privately provided economic security, privately coined money, bank notes, and the like.

Nevertheless, given enough such examples, the individualist convinced of both the spiritual and moral case for liberty will accept the empirical case as well. In so doing, he will add to the claim that liberty is a virtue, the further claim that liberty is a blessing which promotes human happiness. These three philosophical themes taken together both support and are supported by the primal appeal of freedom that is basic to so much of our personalities.

There is a great danger, though, when the primal appeal of liberty is not accompanied by philosophical conviction. For then the temptation arises to use government to expand liberty, rather than to destroy it. Of course, the use of force cannot—by definition—expand liberty, but there are a great many with libertarian sympathies, perhaps including most Americans, but without a sufficient grounding in theory, who think that it can. We might call them social libertarians and their idea, oxymoronic as it is, socialized libertarianism.

To them, as to Lord Acton and philosopher-economist John Stuart Mill, liberty means freedom not just from coercion, but also from the opinions, customs, and traditions of the many. To gain such freedom from the valuations of others, a social libertarian may well be tempted to advocate state coercion not seeing, for the moment, that, as Hayek so beautifully exposits in *The Constitution of Liberty,* the empirical case for freedom holds true of the very opinions, customs, and traditions he feels (but is not coercively) bound by[7] and that, in any case, state action violates the spiritual and moral constraints on coercion he normally accepts.

This blind spot is particularly notable and noticeable in the case of invidious discrimination against members of a minority group. Even those, such as the American Civil Liberties Union, who normally make a very strong case for the freedoms of association (which include the freedom not to associate) and the right to privacy (which includes the right to scrutiny-free relationships) are tempted to make a major exception where invidious discrimination is concerned.[8] The philosophical libertarian, in contrast, distinguishes carefully between persecution and discrimination and while prohibiting the former with all the force of the law and the state, leaves the latter subject to moral opprobrium by the citizenry and to the powerful rectifying institutions of the marketplace.[9]

Social libertarians also might advocate that employers not be allowed to test employees for drugs or truthfulness and that landlords not be allowed to prohibit cohabitation, kids, pets, or washing machines. Both landlords and employers, they advocate, should be required to act neutrally to any attribute of tenants or employees, respectively, that is not relevant to tenancy and employment, respectively.

Arguments similar to those made about employers and landlords were made, and were almost totally successful, about the stewardship function of colleges and universities toward their students, and for such public accommodations as mass transit, restaurants, and the like.

In each of the above cases, although freedom of choice is clearly contracted, the choices available to the advocates of state action have equally clearly been substantially expanded, albeit at the expense of those whose freedom of choice has been contracted. This point is one which causes some anguish for the consistent proponent of liberty, for it is undoubtedly true that in many instances we are prevented from acting as we like or required to act in ways we do not like, even though no coercion is involved.

Yet both the employer's terms and the landlord's terms, as irrational, onerous, or even immoral as they may be, and as little as we wish to defend them, are tacitly accepted by the employee and the tenant in staying on at the job or in the apartment. What social libertarians would do, in essence, is replace the criterion of liberty with one of relevance and reasonableness. If there are not good and sufficient reasons for the conditions attached to the job or the tenancy, they advocate that it must not be allowed to stand.

Furthermore, social libertarians argue, if so-

cialized libertarianism is rejected on the ground that continuance in a position is tacit acceptance, why not try the principle one step further and respond that the coercive powers of the state are also tacitly accepted by anyone continuing to live within its borders?

If there is a weakness with philosophical libertarianism, the social libertarian continues, it is the narrowness of the definition of coercion. In their view, the employer or the landlord does exercise a form of coercion and one which is best prevented by coercion from the state.[10]

These are serious objections which must be addressed and which present difficulties for anyone who has ever held a job or a tenancy with irrelevant conditions (who has not?) or who has been denied a job or a tenancy for irrelevant reasons.

The best response, though, is a simple question: "Irrelevant to whom?" Or, "Reasons not thought good and sufficient by whom?" Obviously not to the employer or the landlord whose liberty it is proposed to limit and whose property it is proposed to regulate. Furthermore, if the employer or landlord *is* wrong about the relevance of his conditions, as is sometimes surely the case, the market will exact penalties in higher salaries, lower rents, and the like.[11] Moreover, such an analysis does not even consider all the harmful side effects of the state's entering the picture, including the often-realized potential for the state to become the final arbiter of what constitutes good and sufficient reasons and what is or is not relevant to what, thus placing the state in effective control over housing and employment, an inevitable outcome that a social libertarian would surely deplore.[12]

Finally, the tacit acceptance of a property owner's conditions—whether the ownership is of a corporation or of rental housing—is not akin to the state's claim over its resident citizens. The state does have sovereignty—a monopoly on the retaliatory use of force within its borders—but it lacks, or should lack, ownership—a monopoly on the control and use of the property within its borders. Ownership arises by what Harvard philosopher Robert Nozick has called "the entitlement theory,"[13] which dates back to John Locke.[14] Sovereignty does not properly confer ownership, and in those polities where it *is* taken to include ownership, there is and can be no liberty.[15] And that is a tragedy which should convince the proponent of socialized libertarianism to acquire a taste for philosophical libertarianism and, despite the temptation, not to compromise so sacred a principle as liberty for an expanded notion of freedom that must diminish the very liberty in whose name it is promoted. □

1. See, for example, Joseph Fulda, "Productive Advances: Who Benefits Most?" in *The Freeman* 37(July 1987): 251.

2. See, for example, George Gilder, "The Economy of Frustration," *Wealth and Poverty* (New York: Basic Books, 1981), pp. 9-20.

3. See, for example, Friedrich A. Hayek, "Freedom as Opportunity for the Unknown Few," *The Constitution of Liberty* (South Bend, Indiana: Gateway Editions, 1972), Chapter 2, section 5, pp. 30-32.

4. See, for example, Milton Friedman and Rose Friedman, *Free to Choose* (New York: Harcourt Brace Jovanovich, 1980), pp. 115-119.

5. See, for example, Joseph Fulda, "The Market and Scarce Resources" in *The Freeman* 34(August 1984): 497; Joseph Fulda, "Product Information on the Market" in *The Freeman* 36(January 1986): 29-33.

6. The classical example here is the tariff, although the principle holds true for virtually all government interventions.

7. Friedrich A. Hayek, "Custom and Tradition," *The Constitution of Liberty* (South Bend, Indiana: Gateway Editions, 1972), Chapter 4, esp. section 5, pp. 61-62.

8. For a clear statement of this, see George F. Will, *Statecraft as Soulcraft* (New York: Simon and Schuster, 1983), pp. 86-87.

9. See, for example, Milton Friedman, "Capitalism and Discrimination," *Capitalism and Freedom* (Chicago: The University of Chicago Press, 1962), pp. 108-118.

10. Friedrich A. Hayek deals with this stubborn issue head-on in "Coercion and the State," *The Constitution of Liberty* (South Bend, Indiana: Gateway Editions, 1972), Chapter 9, pp. 133-147. Space considerations prevent our recapitulating Hayek's discussion; nevertheless, his insight is essential for the philosophical libertarian concerned with the essential principles of liberty, which, with Hayek, we take as "the absence of coercion."

11. See note 9.

12. As an example of this usurpation, the state now regularly decides whether, and to what degree, gender is a relevant criterion in social and economic activity.

13. Robert Nozick, "The Entitlement Theory," *Anarchy, State, and Utopia* (New York: Basic Books, 1974), pp. 150-153.

14. John Locke, "Of Property," *Two Treatises of Government* (Cambridge: Cambridge University Press, 1967), II:5:25-51.

15. See, for example, Joseph Fulda, "Liberty and Property," in *The Freeman* 37(May 1987): 175-178.

The Minimum Wage—Good Intentions, Bad Results

by Roger Koopman

Ideas have consequences, Richard Weaver once wrote. They pace the course of human history—both good ideas and bad. And while intentions may be honorable, the passing of time has proven that, in the long term, you can't get good results from bad ideas.

The minimum wage is a classic example of a good intention and a bad idea. The idea behind minimum wage legislation is that government, by simple decree, can increase the earning power of all marginal workers. Implicit in this idea is the notion that employment is an exploitive relationship and that business owners will never voluntarily raise the wages of their workers. Businesses, we are told, must be coerced into paying workers what they deserve, and only politicians know what this is.

Not only does this line of thinking run contrary to the most basic economic principles of a free society, but it is also patently illogical. If government could raise the real wages of millions of Americans by merely passing a law announcing that fact, then why stop at $3.35 per hour, or $4.65, or even $10? Isn't $500 per hour more compassionate than $50? Absurd, you say, and I would agree. But the "logic" is perfectly consistent with the *idea* of a minimum wage, once you have accepted the premise that political decrees can raise wages.

What does make wages rise? It is most certainly *not* government edicts that simply rearrange and redistribute existing wealth. Wages rise in response to the creation of new wealth through greater productivity. The more that a society produces per capita, the more there is to distribute through the marketplace in the form of higher wages, better benefits, and lower prices.

The "bigger economic pie" concept is not complicated in the least, and yet it is a principle that seems to elude us time and again in matters of public policy. We know instinctively that government cannot create or produce anything. It regulates, confiscates, and consumes, all at the expense of the private economy. And yet we still believe that government can wave its magic wand with laws like the minimum wage, and we all will be better off.

Politicians engage in this deception to buy political favor from special interest groups. We keep falling for these political deceptions because our focus is on short-term personal gains rather than on the long-term consequences to the entire nation. We see the apparent benefit of having our own wages increased. But we don't consider the nameless victims of the minimum wage hike who will lose their jobs because the government has priced them out of the labor market. (It is precisely because minimum wage laws eliminate low-skilled workers from competing in the job market that organized labor lobbies Congress for massive minimum wage hikes.)

Commenting on the minimum wage, economist Henry Hazlitt put it succinctly:

> You cannot make a man worth a given amount by making it illegal for anyone to offer him less. You merely deprive him of the right to earn the amount that his abilities and situation would permit him to earn, while you deprive the community even of the moderate services that he is capable of rendering. In brief, for a low wage you substitute unemployment. You do harm all around, with no comparable compensation.[1]

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The net loss to society that results from this sweeping act of "wrongful discharge" is staggering. Those losses include: (1) The loss of employment to the individual himself, (2) the shrinking of the economic pie by the loss of his productive contribution, (3) the financial loss to society in supporting him in his idleness (unemployment compensation, welfare, etc.), (4) the financial loss in funding useless job training programs and other government efforts to get him re-employed, and (5) the net loss to society in having consumer prices driven up to cover the higher labor costs, and the loss of market share to foreign competition that may occur.

The cruel irony of the minimum wage is that it harms most the very segments of our society that it is intended to help—the unskilled poor and the inexperienced young. The evidence to support this is overwhelming, and it is the black community that is the hardest hit. In the 1950s, black teenage unemployment was roughly that of white teens. Following years of steady increases in both the level and coverage of the Federal minimum wage, over 40 per cent of the nation's black teenagers are now unemployed.

Just look at all the jobs that have been abolished by the minimum wage—good and worthwhile jobs for those who are taking their first step on the economic ladder. Movie ushers, gas station attendants, caddies, fruit pickers, dishwashers, fast food help, and a wide variety of other entry-level job opportunities have been either cut back or eliminated because the minimum wage has rendered them unaffordable. How tragic this is, when you consider the true value of these low-level jobs to young and unskilled workers.

Reflecting on his early years in a Philadelphia slum, black economist Walter Williams observed:

> None of these jobs paid much, but then I wasn't worth much. But the real value of early work experiences is much more important than the little change a kid can earn. You learn how to keep a job. You learn how to be prompt, respect and obey superiors, and develop good work habits and attitudes that can pay off in the future. Additionally, there is the self-respect and pride that comes from being financially semi-independent.[2]

If a young person is willing to wash cars for $2.50 an hour to gain work experience and self-esteem, is it the right of Congress to tell him he can't do it? Is it, in fact, the right of any politician to make these kinds of economic choices for a free people?

Commenting again on the minimum wage, Williams makes this critical observation:

> It is important to note that most people acquire work skills by working at "subnormal wages" which amounts to the same thing as paying to learn. For example, inexperienced doctors (interns), during their training, work at wages which are a tiny fraction of that of trained doctors. College students forego considerable amounts of money in the form of tuition and foregone income so that they may develop marketable skills. It is ironic, if not tragic, that low skilled youths from poor families are denied an opportunity to get a start in life. This is exactly what happens when a high minimum wage forbids low skilled workers to pay for job training in the form of a lower beginning wage.[3]

In a free society, people must have the right to offer their services in the marketplace for whatever price they choose, whether they are workers serving employers or businesses serving consumers. It is by this process that productivity, wage rates, and prosperity are maximized. Government has no more business objecting to a low wage rate for a menial job than it has objecting to a business that offers its services or products for a low price. Government intervention in these matters distorts economic decision-making, misallocates scarce resources, and destroys personal liberty.

If we are to remain a free people, we need to start trusting freedom, and jealously guard our right to make our own choices about our own lives. Repealing the minimum wage law would be an excellent place to start. □

1. Heny Hazlitt, *Economics in One Lesson* (New York: Arlington House Publishers, 1979), p. 135.

2. Walter Williams, "Wage Laws Keep Teens Jobless," *Colorado Springs Gazette Telegraph*, May 16, 1986 (syndicated column).

3. Walter Williams, "Government Sanctioned Restraints that Reduce Economic Opportunities for Minorities," *Policy Review*, No. 2 (1977), p. 11. (Quoted in *Poverty and Wealth: The Christian Debate Over Capitalism*, by Ronald H. Nash, [Westchester, Illinois: Crossway Books, 1986], p. 122.)

The Farm Credit Crisis

by E. C. Pasour, Jr.

Farm credit problems are front page news. In early 1987, 104,000 commercial farm operators (17 per cent of the total) with $28.4 billion of debt were considered to be "under financial stress" so that lenders could lose $6.3 billion on these loans.[1] However, the amount of financial stress in agriculture varied considerably from region to region, being greatest in the Northern Plains, Lake States, and Corn Belt.

The regional variation in problems of farm borrowers is important to farm lending agencies, also under financial stress. The government-sponsored Farm Credit System (FCS) has lost some $4.8 billion since 1985 through mortgage and loan defaults—more than any other financial institution in U.S. history. Congress responded and in late 1987 a multi-billion dollar package of Federal assistance to help bail out the FCS was passed.

The Farmers Home Administration (FmHA) is the primary farm lending agency of the U.S. Department of Agriculture (USDA) with a historical mission of providing credit to high-risk farmers. Thus, the high degree of financial stress by FmHA borrowers in the mid-1980s should not be surprising. A 1986 GAO study found that more than half the FmHA borrowers were either technically insolvent or had extreme financial problems.[2]

It is not only farmers and government credit agencies that are encountering financial problems in farm credit markets. Many of the commercial banks that have failed in the 1980s have been "agricultural banks."[3] Indeed, the closure rate of agricultural banks has been significantly higher than that for nonagricultural banks.[4]

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The purpose of this paper is to show how government intervention has resulted in two kinds of problems related to agricultural credit. First, it is shown how subsidized credit has contributed to the current plight of farmers. Second, the relationship of government banking regulations to farm bank lending problems is stressed. The conclusions reached are that farm credit woes are inherent in "easy credit" policies by governmental credit agencies and in the current system of banking restrictions that reduce portfolio diversification and increase risk.

Easy Credit in Agriculture

Federally subsidized farm credit programs have increased from a marginal source of farm financing for a few hardship cases to a major source of farm credit during the past fifty years.[5] Indeed, about half of the farm debt was held by the FCS and the FmHA in 1987.[6] This figure actually understates the governmental influence on farm credit because the taxpayer-financed FmHA supports agricultural loans by private lenders. For example, a 1984 debt deferral and adjustment program permitted the FmHA to guarantee problem farm loans held by a commercial bank, provided the lender reduced the principal or the interest rate charged by specified amounts.

Easy credit policies in agriculture lead to information problems, incentive problems, and a number of indirect and unintended effects.

Information Problems

In a market system, interest rates and the amount of credit used are determined by market forces. In the absence of a market test, there is no reliable method to determine how low interest rates *should* be or how credit should be allocated. Subsidized credit, in effect, is an income redistribution program. The problem of determining a "fair" interest rate is the same as determining "just prices" generally and is one with which philosophers have struggled for centuries. Economic theory cannot be used to justify credit programs that benefit some farmers at the expense of other farmers and taxpayers—any more than it can be used to justify other income redistribution programs. The conclusion is that any governmentally imposed reduction in interest rates or increase of credit to agriculture is purely arbitrary.

Implementation Problems

Implementation problems arise in subsidized credit programs as they do in all situations in which resources are allocated through the polit-

ical process. The FmHA, for example, was designed to be "lender of last resort," lending to borrowers unable to obtain credit from private credit agencies. In the case of FmHA's so-called limited resource loans, credit is extended when farmers "need a lower interest rate to have a reasonable chance of success."[7] However, when credit is arbitrarily increased to high-risk farmers, too many resources remain in agriculture.

There is also a moral hazard problem in all cases where the FmHA acts as a "lender of last resort." That is, an individual's behavior is affected when he is protected from the consequences of his actions. If subsidized credit is available to a farmer who either cannot obtain credit elsewhere or who needs a lower interest rate to succeed, the farmer is less likely to change his behavior so as to qualify for credit from commercial sources and more likely to continue to need lower rates.

Public choice theory—the application of economic principles to the political process—holds that goods and services are likely to be over-produced when provided through the political process. As the original purpose for a government program is achieved, politicians and decision makers in a government agency have incentives to broaden the scope of the agency's activities to prevent funding decreases.

The theory of bureaucratic productivity appears to be consistent with actions of the FmHA. The mandate of the FmHA has been broadened considerably over time to include loans for rural housing, community facilities, and business and industry programs, so today FmHA credit is available in rural areas for almost any conceivable purpose.[8] By 1982, only about half of all FmHA loans and grants were for farm programs.[9]

The FmHA provides a good example of how subsidized credit is influenced by political considerations. A tightening in FmHA rules, especially foreclosure, is politically sensitive. Both Secretary Bergland in the Carter Administration and Secretary Block in the Reagan Administration imposed a moratorium on farm foreclosures. Yet, without a firm foreclosure policy, goverment lending agencies are likely to get dragged into economic ventures that are progressively more hopeless. In contrast, when credit is available only from private lenders, who expect to profit from lending, there is much less likelihood of overexpansion of landholding or capital facilities in farming.

Indirect Effects

Subsidized credit affects the profitability of production and influences which producers remain in production. When allocated on the basis of its opportunity cost, credit generally is used by those producers meeting the profit test—those who best accommodate consumer demand. On the other hand, some less productive producers are kept in production when credit is subsidized, resulting in higher prices for land and other specialized resources, increased output, and lower product prices. Thus, farmers *not* receiving subsidized credit are harmed, since this results in higher costs and lower product prices.

The market process by which competition weeds out less productive producers and rewards the more productive is altered when subsidized credit is extended to those who are failing and cannot obtain credit elsewhere. Subsidized credit hampers resource adjustments and perpetuates low income problems in agriculture. One economist explains this paradox in which government assistance to agriculture benefits the less productive at the expense of the more productive, thereby reducing overall productivity, as follows:

> Financial assistance provided through the subsidies to the least efficient farmers leads to lower farm commodity prices and higher cost of farm resources, especially land, and reduced farm incomes. This tends to place the next group of farmers on the efficiency scale in the failure class. This process of replacing marginal farmers with otherwise submarginal ones results in a gradual reduction in the overall efficiency level of lower income farm groups.[10]

Easy credit also has affected production methods and the structure of farming. It has led to the substitution of machinery and other capital inputs for labor in agriculture, resulting in more highly mechanized farms. Lower interest

rates also have encouraged farmers to buy more land. In view of widespread public concerns about farm size and capital requirements in commercial agriculture, it is ironic that government credit programs have contributed to the trends toward larger and more highly mechanized farms. It is also ironic that government has subsidized credit, thereby increasing output of farm products while, at the same time, attempting to reduce farm output through various other agricultural programs.

The effect of easy credit policies during the agricultural boom of the late 1970s on farm woes of the 1980s warrants a special note. Cheap credit creates an incentive to expand the size of farm operations through borrowing. And "too much" credit is more likely to be extended when lenders do not bear the full consequences of their actions. In the late 1970s, a period of inflation and favorable product prices, farmers borrowed heavily to invest in land, machinery, and other capital facilities. In retrospect, many highly-leveraged farmers borrowed too much. And they would not have borrowed so much if they had had to pay credit rates that were not subsidized, implicitly or explicitly, by the FCS and the FmHA.

As long as farm land prices were rising rapidly, as during most of the period from World War II to 1981, farms generally could be sold for enough to liquidate the debt when high-risk and other farm borrowers went out of business. With the decline in farm real estate values since 1981, however, losses by FmHA and FCS borrowers have been at a high rate. Hence, the evidence suggests that easy credit programs, especially those of the FmHA have "prolonged the agony of many farmers who should have transferred to nonfarm occupations at the time the FmHA loans were made."[11] Thus, there can be little doubt that the easy government credit policies of the 1970s contributed to the financial distress and farm bankruptcies of the 1980s.[12]

Finally, the cost of subsidized credit in agriculture ultimately is borne by the public. The federal government can finance its programs by raising taxes, deficit spending, or through new money creation. In reality, all these financing methods are likely to be used, resulting in higher interest rates, higher taxes, and inflation.[13] To maintain political support for subsidized credit, it is important that the costs be widely dispersed and not easily determined, while the benefits be easily seen and heavily concentrated—a phenomenon characteristic of many governmental programs that redistribute income.

Government-Assisted versus Private Credit in Agriculture

The objective of Federal credit agencies is quite different from that of profit-seeking private credit institutions. The purpose of the former, as stressed above, is to offer terms and conditions to selected borrowers that are more favorable than those available from private lenders. When compared with fully private loans, government-assisted credit may include lower interest rates or loan guarantees, less stringent credit risk thresholds in making credit available, or more generous repayment schedules.

Federally sponsored and financed agricultural credit programs have been under a great deal of financial pressure because their loans are specifically for agriculture, which is experiencing the greatest amount of financial turmoil since the 1930s. As suggested above, many commercial banks with high percentages of agricultural loans in their portfolios have also been in trouble during the 1980s. There is no way to diversify risks under current institutional arrangements when credit institutions deal heavily with one sector of the economy, whether the credit institutions be public or private. This is explained in the following section.

A problem is likely to arise when a credit institution in a predominantly agricultural location is not able to diversify its risks outside its geographic area and outside of agriculture. This inability to diversify risks is inherent in the FCS and FmHA. It is also a problem for commercial banks located in predominantly agricultural areas, such as those in parts of the Corn Belt, which cannot diversify their risks because of government restrictions on branch banking. Branching within states is governed by state laws, and only about half the states allow unlimited branching within their borders.[14]

A recent study of agricultural bank lending practices by the Federal Reserve Bank of

Dallas found that branch-banking regulations have increased the probability of bank closure. One of the advantages of branching is increased diversification. Greater diversification means less risk and, consequently, a lower probability of banks' closing. In states with a broad mixture of industrial, commercial, and agricultural businesses, but with geographical concentration of agriculture, statewide branching can reduce significantly the risk of bank loan portfolios.[15]

The significance of portfolio diversification through branch banking in states with a great deal of diversity is illustrated by the banking situation in California (which allows statewide branching). Although California is the most important agricultural state, the state is so diverse that less than 5 per cent of all bank loans are to farmers and ranchers. Consequently, agricultural lenders there have fared much better than agricultural banks generally. Despite the importance of agriculture, California accounted for only one of the 68 agricultural bank failures in 1985.[16]

Statewide branch banking would have much less effect on portfolio diversification in states heavily concentrated in agriculture (or in any other line of commerce). In Nebraska, for example, a restricted branching state, loan portfolios are heavily loaded with agricultural loans. In 1984, 38 per cent of the loans were to farmers "and probably half again as much was to farm-related businesses."[17] At the end of 1984, there were 413 agricultural banks in Nebraska—19 have since closed.[18] In situations in which agriculture is the dominant activity and there is little opportunity for diversification, statewide branching would have relatively little effect in reducing lending risk.

Interstate Banking

Restrictions on banking make farm lending more risky. Partly as a result of geographical restrictions on banking, two-thirds of all bank failures in 1986 occurred in the Kansas City and Dallas Federal Reserve Districts, home to many poorly diversified farm and energy banks.[19]

In states in which there is a heavy concentration in agricultural production, or more generally in a few lines of commerce, geographical restrictions on banking significantly reduce portfolio diversification. Consequently, banks operating across state lines are able to diversify their risks much more effectively than banks restricted to a given geographic area. Although bank holding companies have engaged in a modest amount of interstate banking in recent years, Federal laws such as the McFadden Act and the Bank Holding Company Act limit full realization of the benefits of interstate banking.[20]

A bank that makes loans in different regions does not have its fate tied to the economy of one region. Specifically, under a system of interstate banks, a bank in a farming region would not have all its loans dependent upon the farm economy. Thus, it is not surprising that Federal and state restrictions on branching appear to have played an important role in recent woes of agricultural banks.

Restrictions on banking, as they affect agricultural credit, illustrate the point made by Ludwig von Mises that government intervention creates pressures for further intervention. Government restrictions on bank branching within and between states make it much more difficult for banks in agricultural regions to diversify their portfolios—hence, the government-created "need" for government-operated and government-sponsored credit institutions.

Restrictions on competition in banking are similar in one respect to governmental restrictions on competition in agriculture. In each case, the restrictions represent successful attempts by politically powerful groups to achieve wealth transfers through the political process. Many banks oppose nationwide banking, just as many farmers oppose free markets, because it would subject them to increased competition.[21] In neither farming nor banking, however, is there any persuasive evidence that current restrictions are beneficial to the public at large.

Conclusion and Implications

Government intervention in credit markets has been harmful in a number of ways. Easy credit has increased the amount of credit used in agriculture—especially by high-risk borrowers. Hence, it contributed to the increased

prices of farm real estate and the increased numbers of highly leveraged farmers of the 1970s—and, consequently, to the financial and farm bankruptcies of the 1980s.

Subsidized credit has enabled many farmers who otherwise would have shifted out of agriculture to continue farming. And the resulting higher cost of land and other farm resources, increase in output, and decrease in commodity prices have reduced incomes of farmers not receiving the benefit. Economic logic supports the conclusion of Clifton Luttrell, former agricultural economist with the Federal Reserve Bank of St. Louis: "Instead of alleviating the problem of poverty in agriculture, as often alleged, such credit perpetuates the problem."[22] From a nonfarmer and taxpayer point of view, the increased flow of credit to agriculture means some combination of higher interest rates, higher taxes, and inflation.

Subsidized credit as a public policy poses the same problems as other kinds of intervention affecting market prices. The market process allocates credit on the basis of expected productivity and profits. In the absence of the profit and loss benchmark, there is no objective basis for determining how much credit *should be* used in agriculture. Thus, it is impossible to determine how effectively credit is being used in government credit programs. Moreover, the moral hazard problem is endemic in easy credit programs where borrowers must demonstrate that they lack other sources of credit.

A number of arguments have been used to justify cheap credit in agriculture. A recent analysis of the most widely used arguments concluded that the arguments were either unsound, counter to economic logic, or not supported by the evidence.[23]

Government intervention affecting the abilities of agricultural credit institutions to diversify portfolios also is harmful. Problems arise when lending institutions deal only with one sector of the economy—whether the credit agencies are public or private. Government restrictions on nationwide banking reduce diversification in bank loan portfolios, thereby increasing risk and the likelihood of bank failure. Branch banking regulations, by making lending in agriculture more risky, also increase pressures for easy credit programs through government credit institutions.

The analysis suggests three main points. First, cheap credit has hampered resource adjustments and contributed to current financial stress in U.S. agriculture. Second, government restrictions that prevent nationwide banking have increased risks of banks specializing in farm loans. Third, government intervention affecting farm credit and banking has had unforeseen and unintended consequences. In this respect government programs affecting agricultural credit markets are no different from government programs generally. □

1. Steven R. Guebert, *Agricultural Situation Report* (McLean, Virginia: Farm Credit Administration, September 18, 1987).
2. General Accounting Office, *Farmers Home Administration: Financial and General Characteristics of Farmer Loan Program Borrowers* (Washington, D.C.: U.S. Government Printing Office, 1986), p. 2.
3. Agricultural banks are defined in different ways, but most definitions are based on the percentage of agricultural loans in a bank portfolio. Hilary H. Smith, "Agricultural Lending: Bank Closures and Branch Banking," *Economic Review* (Dallas, Texas: Federal Reserve Bank of Dallas, September 1987), p. 27.
4. *Ibid* p. 27.
5. Clifton B. Luttrell, "High Costs of Farm Welfare via Federal Programs: An Analysis of Their Origin, Growth and Effects," unpublished manuscript, 1987.
6. Emanuel Melichar, *Agricultural Finance Data Book* (Washington, D.C.: Board of Governors of the Federal Reserve System, June 1987), p. 19.
7. U.S. Department of Agriculture, *A Brief History of Farmers Home Administration* (Washington, D.C.: U.S. Government Printing Office, 1983), p. 15.
8. Clifton B. Luttrell, *op cit.*, p. 114.
9. U.S. Department of Agriculture, *op cit.*, p. 19.
10. Clifton B. Luttrell, *op cit.*, p. 133.
11. *Ibid.*, p. 121.
12. Michael T. Belongia, *Agriculture: An Eighth District Perspective* (St. Louis, Mo.: The Federal Reserve Bank of St. Louis, Spring 1984).
13. Clifton B. Luttrell, *op cit.*, pp. 124-126.
14. Hilary H. Smith *op cit.*, p. 32.
15. *Ibid.*
16. Lindley H. Clark, Jr., "Interstate Banks Could Ease Farm Credit Woes," *The Wall Street Journal,* January 20, 1987, p. 35.
17. Hilary H. Smith, *op cit.*, p. 32.
18. *Ibid.*
19. Michael Becker, Steve Horwitz, and Robert O'Quinn, "Interstate Banking: Toward a Competitive Financial System," *Issue Alert* No. 18 (Washington, D.C.: Citizens for a Sound Economy Foundation, 1987), p. 9.
20. *Ibid.*, p. 13.
21. *Ibid.*
22. Clifton B. Luttrell, *op cit.*, p. 133.
23. Dale W. Adams, "Are Arguments for Cheap Agricultural Credit Sound?" Ch. 6 in *Undermining Rural Development with Cheap Credit,* Dale W. Adams, Douglas H. Graham, and J. D. Von Pische (eds.) (Boulder, Col.: Westview Press 1984), p. 75.

The Morality of Freedom

by Robert A. Sirico

Lenin is reported to have once said that ideas are more fatal than guns. His revolution proved him right. Although Lenin's observation is overly negative (ideas needn't be fatal; they can, after all, be life engendering) it is correct to say that ideas have consequences, and that values, too, have consequences, for in the last analysis, there is a relationship between what we think and what we value. Ideas form the basis for people's actions, whether good or ill, whether explicit or implicit, and values result in various forms of human relationships and societies.

This essay is hardly meant to offer a thorough philosophical grounding for the moral basis of a free human community. In the light of space limitations I would be content merely to draw some useful distinctions, raise some infrequently asked questions, and test some dearly held axioms. I may provoke some questions and perhaps some disagreements, and this I welcome.

To probe this topic effectively, I have divided this essay into two sections. The first deals with clarifying some concepts and phrases which I believe have become blurred in common parlance. In the second section I hope to indicate some of the theoretical foundations of why it is that people can be said to possess rights, what these are, and what the necessary preconditions are for a truly humane society.

My final prenote is to observe that while the ideas that I present are drawn from the Judeo-Christian tradition, their application and significance go well beyond that tradition. My argument may be accepted by all people who are willing to banish the use of coercion and fraud to achieve social or political goals, regardless of their particular faith or lack of it.

It has been said that the mark of the mature mind is its ability to make distinctions, and it may be that as people become more and more acquainted with the intricacies of various aspects of reality, they begin to see various shades of meaning and are more able to distinguish among things that might have otherwise appeared to be indistinct. At least this is the case with the Eskimos who, I am told, have thirty different words for snow.

When we look, then, to human arrangements, it is imperative that we have a clear idea about what it is to which we are referring.

One hears a great deal of talk today about "rights." My philosophy professor at USC, Dr. John Hospers, used to say that there has been a "rights inflation." Yet, for all the talk about rights, what is oddly absent is a clear understanding of what rights are.

Rights are those claims which the individual has against others. In order for them to be unalienable, as the Bill of Rights proclaims them to be, rights must be seen as existing prior to and independent of any legal or institutional rules. Laws and institutions, by this understanding, may obfuscate, violate, or even protect an individual's rights, but they can neither grant nor remove true human rights. Rights, in order to be true claims which are unalienable and fundamental, must exist independent of the caprice of those who have coercive power. Additionally, in order for rights to be all that we have just said, they must derive from the nature of the case, which is to say that the human person must possess rights by virtue of his or her very nature.

I will elaborate on this in the second section of this study. For the present it is only necessary to understand the distinction between rights as just claims and as favors or privileges. A favor cannot be claimed. The nature of a favor or a privilege is that it is granted at the pleasure of the grantor. A favor may be withdrawn by the grantor when the one to whom it

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was granted falls out of favor. This not the case with rights.

Another basic distinction I wish to draw is that which exists between a community or society and a government or political order. This is to say that a society may exist with or without a particular political arrangement. Perhaps this is made more clear by seeing how Philippine society continued to exist despite the deposition of the Marcos political regime. The political order or government is that entity which maintains a monopoly of force in a given geographical area.

A community, on the other hand, is distinct in that its members hold certain values, *mores*, customs, and other such things in common, but is not essentially marked by its coercive capacity. Thus we can speak of "the Jewish community of Rome," for instance.

Communality vs. Collectivity

For the purposes of this treatment, and in the interest of precision, I would like to draw a distinction between a commune and a collective, again using coercive capacity as the dividing line. We would then be able to speak of people who enjoy a life in common, sharing values, homes, philosophy, and even wealth, without thinking of them as collectivists. In the former instance people come together freely, whereas in the latter they are forced into a common life.

While this distinction is not mandated by the language, I think it is permitted, and for the purpose of this discussion, desirable for clarity.

Similarly under this heading I would like to include a distinction between cooperation and conformity, again where the former involves choice but the latter is enforced.

Aristotle teaches us that justice is treatment in accord with desert. If I hire a man to mow my lawn for X amount of dollars, it is not charity, but justice that I pay him the amount agreed upon. Should I choose to add on to this just amount an additional gratuity—it is just that, a gratuity, an act of favor or charity on my part, but not something that is demanded by justice.

All these distinctions will aid us in understanding the theoretical foundations of a free society.

The Foundations of Freedom

A. Freedom: A Necessary Precondition for Morality and Virtue

Before we can speak intelligently about morality and virtue, it is necessary to speak about liberty and volition. The simple reason for this is that nothing can be said to be good, other than in a merely functionist sense, unless it is chosen. A morality that is not chosen is no morality. The moral status of those from whom Robin Hood robbed could not be said to have been elevated by the fact that their money went to help the poor for the simple reason that they did not freely choose to share their wealth. So, whatever other noble purposes one might want to identify with the forced sharing of wealth, morality cannot be one of them. In fact, the same question might be directed at the virtue of nobility, or heroism. Can a person be said to be noble or heroic if it were not a freely chosen action on his or her part that displayed either nobility or heroism? When freedom is absented from the context of morality, nobility, or heroism, the result is *non*sense in the truest meaning of the word.

Only beings with volition can be said to be moral, and in order to act in a moral way one must have liberty. In this understanding, liberty is not so much a virtue *per se* as much as it is the only context in which virtue is possible.

B. Two Levels of Morality

As one who believes in liberty, for myself and for others, I see two levels or sets of values that should be identified.

The first is the general context of relations among people, the overarching milieu in which people are allowed to associate and establish relations with one another. In this general social context, everyone's freedom extends precisely to the liberty of another. No one objects to the notion that people have the right to agree with one another; it is when people choose to *disagree* with one another that the clear line of freedom must be drawn. I submit that the only way in which a society can function that is consistent with human nature (which I will outline in due course) is the society wherein all relationships are voluntary and where the initiation of coercion is banned.

This human (and I contend, humane) arrangement will provide for a wide pluralism, sufficient in its various manifestations, I am sure, to disturb and offend everyone reading this article. However, this arrangement will not allow anyone to force me to lend my moral sanction to his actions, or coerce me into supporting activities of which I do not approve.

The second set or level of values are those which pertain to the individual as he or she exercises his or her liberty. Again, these values will be diverse. For some, these values will be acquired on the basis of their family, culture, religion, and the like. The only limit on the exercise of their values will be that individuals agree to the equal right of others to pursue their own vision of morality. Here again, initiated coercion and fraud will be banned.

Thus, while two levels or sets of values may be identified, both political and individual freedom mean the absence of coercion by one of another.

C. The Uniqueness of Human Beings

Santayana once said, "to be is to be something in particular," and it is with this focus that we can explore what it is about humans that justifies their having rights and what those rights are.

One thing which the human person is "in particular" is a concrete body which puts the human person into some kind of relation with the material order. Observe how humans are related to the natural world in a way uniquely different from animals. Animals are bound to things by instinct; humans are related to things by reason, and this is the other thing which humans are in particular: We are self-reflecting, thinking beings who survive by the use of our reason. The mind is the predominant element which makes humans distinctly human. Thus, we are generically and essentially distinct from the animal which cannot reason. (I prescind here from the debate over whether some animals can reason; my focus here is on the human person.)

The rational relationship between the human person and nature is what gives rise to property. It is our capacity to reason, our rational faculty, which causes us to relate to the material order in a way that is more than immediate and temporary: our relation to the material order is, rather, general and permanent. Stability and permanency are the expression in time of the universality of the relationship of humans to things.

Nor is ours merely a relationship of consumption, but possession and production. Property is the foundation and context of this relationship. By the relationship of the human person to nature, we leave the imprint of our individuality upon nature by means of the time, effort, and ability we extend which in turn produces wealth and property.

Wealth and property do not exist in the state of nature, where, Hobbes said, life is "solitary, poor, nasty, brutish, and short." They come into existence only when people place value on things. This is seen in that black, sticky, smelly, unpleasant substance that was mostly an annoyance until a way was found to process and refine it in such a way that petroleum was produced. When viewed in this light, property rights are really an expression and a safeguard of the personal rights we discussed earlier. The defense of the right to property, then, ought not be seen as the defense of detached material objects in themselves, but of the dignity, liberty, and very nature of the human person who, to allude to Locke, has "mixed his or her labor with nature" to produce property. The right to property, then, is an extension and exercise of human rights.

Perhaps the greatest economist of this century, Ludwig von Mises, drew the connection between economic and personal liberty very clearly when he said, "Choosing determines all human decisions. In making his choice man chooses not only between various material things and services. All human values are offered for option." Milton Friedman put it this way: "Choice is fundamental to economics because it is fundamental to the moral nature of man."

It is crucial to recall that before becoming what some have called "the first economist," Adam Smith was a moral philosopher. Although he wrote the famous *Wealth of Nations*, few people realize that his companion work is entitled *Theory of Moral Sentiments*.

This brings us to what a society organized on the basis of these principles would look like.

The Effects of Freedom

Throughout this article I have attempted to keep in focus the human person as the central actor. Hence, we are justified in asking how a free society would affect people. In discussions of the ideal of a free society one frequently hears voiced the contention that, while the theory is consistent and admirable and although maximum freedom is desirable, it is impractical given the present structures of our society. The liberals, these skeptics would argue, would be delighted with freedom in the bedroom but not in the marketplace, and the conservatives want freedom for big business, but not in the bedroom.

To this objection I would say, "A plague on both their houses." It *will* continue to be improbable to bring about a consistently free society if those of us who believe in the ideals of freedom refrain from questioning the wisdom of the status quo and buy into the standard left-right political continuum. Both sides of the political spectrum, to various degrees depending on the issue, become oddly similar when it comes to the means they intend to use to achieve their goals, namely force. There is an alternative. It is radical, in the sense that it goes to the root of the problem, and it is somewhat, dare I use the word, unorthodox.

But isn't this the case with all human progress? Most often an individual comes on the scene with a new idea, by definition unorthodox at the outset. Those in the status quo point out how this has never been done before and that if it were a good idea, someone would have already thought of it. This was probably the case when the first wheel was invented (We can hear them asking, "What's that for? Who needs it?"); when the combustion engine was developed ("It will scare the horses," they said at the time); the airplane ("Those Wright brothers are crazy anyway—people flying? Nonsense!"); and the development of the microchip. (This article was prepared on my faithful Kaypro computer, but the technology remains a mystery to me.)

If orthodoxy is coercively enforced, progress will be stifled and people will stagnate. Enforced orthodoxy, whatever form it takes, and it comes in a variety of shapes, sizes, and packages, simply means that someone or some group has decided to substitute their reason and perception for someone else's.

I sense the question forming in some minds at this juncture: Shouldn't the needs of the poor be met, and how will this take place in the kind of society organized along the lines you have sketched? I commend this social concern. Yet, for the poor to be lifted out of poverty, more than social concern is needed. Action is needed, specifically economic action.

People speak as though wealth is the natural state of humanity, as though it always existed and that the exception to this rule is its absence. Yet, even the most superficial overview of history belies this fantasy. It is wealth that is the exception: poverty and scarcity have been the norm. Capitalism hardly produced poverty; what it did do, however, was to produce sufficient wealth to show that poverty was not a necessity, that the masses were not condemned to live in abject material want. Poverty was the norm until a change took place in the ordering of social relations. Roughly speaking, this occurred in its most systematic and intellectually observable form in the founding of the United States and in the philosophical and moral thought which preceded it and was its *zeitgeist*.

Despite this clearly observable fact (i.e., that wealth has been the exceptional human circumstance and poverty its most frequent), very few moralists have ever asked: What are the moral conditions crucial to the production of wealth? Even within my own, expansive, Roman Catholic tradition, most of the discussion has centered on distributive justice, with very little attention to productive justice. I suggest that such an approach is to have the cart before the horse.

At the outset of this essay I referred to Lenin's observation that ideas are more fatal than guns. This is the case when ideas are warped, when they fail to include the whole picture, or when they are employed coercively.

I trust that the preceding set of ideas, which has attempted to display the interconnection between morality and freedom, will prove to be anything but fatal, and that they will indicate a preferable, more humane way to order social relations. □

A REVIEWER'S NOTEBOOK

Debts and Deficits

by John Chamberlain

Hans F. Sennholz, who has been featured for years in *The Freeman,* still counts in his native German, but otherwise he both thinks and writes in as forceful English sentences as anyone is apt to see. His book called *The Politics of Unemployment* was reviewed in this space in the December 1987 issue. It made the incontestable point that labor laws, including the minimum wage, keep wages from falling to levels that would clear the market and create full employment.

Now Professor Sennholz has come out with a new book called *Debts and Deficits* (Libertarian Press, Spring Mills, PA 16875, 189 pp., $7.95 paper). It makes the point that deficits do matter. The time must come when bad investments have to be written down or written off. So we face a coming storm at some indeterminate future. The economists will be quick to say that credit contraction is the cause of the depression, or recession, or whatever. But Sennholz tells us that most economists are poor historians. The credit contraction is a symptom of the readjustment process, not the cause.

The depression of the 1930s was, says Sennholz, the inevitable consequence of the credit expansion that preceded the contraction. (Here he follows his Austrian mentor, Ludwig von Mises.) The difficulties were compounded in 1929 and after by stupid political policies everywhere. Economic nationalism eroded the world division of labor. The Hawley-Smoot tariff, passed in 1930, raised American tariffs to levels that practically closed our borders to foreign goods. Other countries were quick to retaliate. Our export industries fell into deeper and deeper depression, and our farmers, who had been struggling anyway, could no longer make ends meet.

The obvious cure in 1932 would have been to take government off peoples' backs. But in the midst of depression which had an unemployment rate of 20 per cent, Congress doubled the income tax. Estate taxes were boosted, gift taxes were levied with rates going as high as some 33 per cent. Hoover stood for all of this, but Roosevelt did no better. His National Industrial Recovery Act increased payrolls, which momentarily added to the purchasing power of a few but took investment money away from non-monopolistic businesses. Peoples' gold holdings were confiscated. The Agricultural Adjustment Act destroyed little pigs and cut the planting of crops, which raised the price of food in the cities. The National Labor Relations Act, which created the National Labor Relations Board, led to thousands of strikes.

As Sennholz says, individual enterprise at this point "just did not have a chance."

No two periods are ever precisely alike, but Sennholz doesn't think our politicians have learned much from the Thirties that would be applicable today. We still talk of raising taxes. We still believe in the spread of redistributive entitlements.

The interesting thing about Sennholz's proposals is that he doesn't blame our politicians for the fix we are in. He blames the moral condition of the country. In a final chapter called

Debts and Deficits

by Hans F. Sennholz

I OWE YOU

Debts and Deficits is published by Libertarian Press and is also available from The Foundation for Economic Education. 189 pages, paperback **$7.95**

"Eternal Hope: A Moral Standard" Sennholz, following Leonard Read, says that reform, like charity, must begin with the individual. "Once accomplished at home," he writes, reform "will radiate outward, kindle new light, and spread in geometric proportion. The true reformer is a seminal reformer, not a radical. He does not pass laws that mandate the reformation of others. He himself makes a beginning and does not think of himself as a reformer. The world may reject him as odd, impractical, and even irrational; but he clings to his principles, regardless of the world around him. There is boldness, a spirit of daring, in the heart of a reformer."

Our transfer system is based on political expedience, but it is also founded in political immorality. Here Hans Sennholz invokes the eighth and tenth Commandments. Theft and covetous yearnings cannot be justified by bringing government into the picture. There won't be much change until individuals begin to take Mosaic law seriously. Sennholz suggests that individuals should be informed of the nature and source of their Social Security benefits. Every check should carry a stub that reveals the cumulative amount of benefits received as of that check. The shocking revelation that one has withdrawn $69,501.15 when he or she has contributed a paltry total of $817.15 would "soon silence the most common defense: 'I paid in.' "

When the total benefits received in retirement exceed the contributions made during working years, a Social Security recipient should submit to a means test. Those who can cover their own expenses should be expected to do so. Millionaires should be expected to pay their own bills. Anyone willing to assume self-responsibility for old age and medical expenses should be encouraged to do so.

Sennholz, seeking a dismantling of Social Security and Medicare in an orderly fashion, suggests beginning with a spending freeze that would call a truce in the political struggle. Senator Domenici of New Mexico has proposed that Congress freeze Fiscal Year 1988 budget authority at Fiscal 1987 levels. Fiscal 1987 spending has been estimated at $1 trillion and revenues at $850 billion. Predictably revenues will rise to $996 billion in 1989 and to $1.058 trillion in 1990. Assuming a freezing of expenditure levels at 1987 levels until 1990, the Federal budget would then be in the black.

The Domenici proposal is better than nothing, but Sennholz says it still attacks symptoms instead of the disease. The root cause of evil, the transfer mentality, would remain to generate outlays under conditions of surplus faster than revenue can be collected. □

ECONOMIC LIBERTIES AND THE JUDICIARY

Edited by James A. Dorn and Henry G. Manne

George Mason University Press, 4400 University Drive, Fairfax, VA 22030 • 1987 • 414 pages • $28.00 cloth; $15.75 paperback

Reviewed by Tommy W. Rogers

Economic Liberties and the Judiciary consists of twenty-three essays by scholars from academia and jurisprudence who deal with the theory and practice of constitutional interpretation and the manner in which economic issues have been handled by the courts. They address such issues as the growing failure of the judiciary to protect economic liberties of human rights in property; the legitimate role of the judiciary—and of government and law generally—in a free society; and the implications of the demise of substantive due process when dealing with economic relationships and the market order. This volume challenges and reassesses attitudes that have long dominated constitutional law and have provided the operative notions for public policy. Now, for the first time in a generation, disciples of the current doctrine of "misguided judicial activism" are being forthrightly challenged on doctrines they have accepted on faith since the New Deal. This confrontation is important because the debate over the Constitution with respect to its guarantees of human rights in property and in economic liberty is, as the editors put it in their Introduction, "a debate over whether the Constitution will survive as a charter for limited government and individual freedom. . . ." □

AMERICA'S MARCH TOWARD COMMUNISM: FORSAKING OUR HERITAGE

by Mark W. Hendrickson

Libertarian Press, Spring Mills, PA 16875 • 1987 • 102 pages
$6.95 paperback

Reviewed by Carl O. Helstrom, III

Mark Hendrickson systematically discusses the ten points of the *Communist Manifesto* in light of twentieth-century legislation and popular opinion in the United States, and makes a strong case for his thesis: "The United States has marched far down the road to Communism," in the sense that we have enacted into law the very agenda proposed by Marx in 1848. At the same time, Hendrickson makes a strong case for the free market economy.

Following the step-by-step treatment of the *Communist Manifesto,* the author suggests ways to reverse the "march." He recommends three constitutional amendments and adds "A Call to Action."

This monograph will be useful to anyone reading or rereading the early works of Marx—and it carries a powerful message for those who may have forgotten that the important battles are in the realm of ideas. □

THE FREEMAN
IDEAS ON LIBERTY

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THE FREEMAN
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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Bruce M. Evans, chairman; Thomas C. Stevens, vice-chairman; Joseph E. Coberly, Jr., vice-president; Don L. Foote, secretary; Lovett C. Peters, treasurer.

The costs of Foundation projects and services are met through donations. Donations are invited in any amount. Subscriptions to *The Freeman* are available to any interested person in the United States for the asking. Additional single copies $1.00; 10 or more, 50 cents each. For foreign delivery, a donation of $10.00 a year is required to cover direct mailing costs.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

Taken for Granted

There is a sense in which being taken for granted is a compliment. A person who takes me for granted has assumed my reliability, trustworthiness, and competence. I have been perceived not as a variable—the fickle subject of random change—but as a constant.

But being taken for granted can also irk. It can be perceived as indifference, as a lack of interest or concern. Indeed, a person who habitually takes another for granted, never expressing appreciation of that person's activities, runs the risk of jeopardizing the very relationship he or she values.

Many today take the productive genius of the free market for granted. They assume a bountiful supply of goods and services, and devise elaborate schemes to secure a "fairer" distribution. Burdensome regulations are placed on those creating wealth. In the name of compassion, market prices are overruled.

But in so doing, the market is fettered and its subtle operations flounder. Information signalled by changing market prices is distorted. Labor, capital, and raw materials are misallocated. The material abundance cavalierly taken for granted is threatened.

The productive capacity of a free market in one sense can be taken for granted. The market can be relied upon, trusted, and thus "assumed." Yet when this reliance leads to policies which defy the economic laws governing the market, or to a disregard of the moral values the market presupposes, the ultimate destruction of what has been taken for granted is guaranteed.

—John K. Williams

The Underclass

What prevents men and women in the inner city from advancing is not racism and not a lack of government programs. We have had, in recent years, more government programs and less racism than ever before—yet the underclass has been multiplying at an ever more rapid pace. For any group to advance, what is required is self-discipline, deferring immediate

gratification for long-run goals, and a willingness to commit oneself to hard work. The dramatic strides made by recent immigrants from Southeast Asia—who possess such a value system—indicate that difference of race, language and culture is no impediment to progress.

Black organizations and leaders should be asking themselves how they can assist in promoting such a value system among young people in the inner city. Instead, they continue to speak of more programs, more government spending, and more of the very things which have grown precisely as the underclass has grown. Needless to say, many of those who advocate such counterproductive public policy have a vested interest in such programs. They may be helping themselves, but they have not been helping the pregnant teenagers, the illegitimate children, the one parent families and the young people caught in a dead end of drugs and crime in whose name they speak.

For many years, the black civil rights establishment succeeded in intimidating other Americans, black and white, from confronting the growing inner-city underclass. The fear of being called "racist" was enough to silence many. Yet, today, the explosion of illegitimate births and crime—of drug addiction and every form of social pathology—can no longer be ignored. Finally, it is on the national agenda for discussion and debate.

—J. A. Parker, Editor
Lincoln Review

Freedom to Move

The greatest danger to the country, to individual employees and to the companies involved is governmental policies that tend to lock companies and employees in place rather than encourage the expeditious movement of personnel and capital out of declining industries and into the new, evolving growth industries.

—Martin Stone, Chairman
Monogram Industries

Russian Humor

You can tell a lot about a country from its humor. Here is a joke which is making the rounds in the Soviet Union:

A man goes to buy a car. He puts down his money and is told by the clerk that he can expect delivery in exactly ten years.

"Morning or afternoon?" the purchaser asks. "Ten years from now, what difference does it make?" replies the clerk.

"Well," says the car buyer, "the plumber's coming in the morning."

—*The New York Times,* August 21, 1987

Good Questions

Is there a compelling national interest in improving gourmet salads? Congressman Silvio Conte of Massachusetts, the ranking Republican on the House Appropriations Committee, apparently thought so when he earmarked $60,000 for a Belgian Endive Research Center at the University of Massachusetts at Amherst. Is U.S. foreign policy served by the $8 million that Sen. Daniel Inouye of Hawaii, chairman of the Senate Appropriations Subcommittee on Foreign Operations, set aside for a language school for Sephardic Jews in France? Do Alaskan fishermen really need the $2.6 million that Sen. Ted Stevens won to "develop fishery products"? Are America's economic interests truly met by the $6.4 million federally funded Bavarian-style ski resort that Sen. James McClure brought home to spur development in Kellogg, Idaho?

—*Newsweek,* January 18, 1988

THE FREEMAN
IDEAS ON LIBERTY

Equal: But Not the Same

by Edmund A. Opitz

The real American revolution of two hundred years ago took place in the minds of people; it was a philosophical revolution which evolved a new temper and state of mind. There were some daring assumptions about the nature of the human person, with his Creator-endowed rights, as set forth in the catalog of self-evident truths contained in the Declaration of Independence. The acceptance of these novel truths about the human person led logically to a new conception of government, a theory of right political action radically different from all previous theories of the purposes of government in human affairs.

Government, according to the Declaration, is instituted for one purpose only—to secure every person in his God-given rights. Period. No longer was the State to exercise the positive function of ordering, regulating, controlling, directing, or dominating the citizens. The new idea was to limit government to a negative role in society; government's task is to protect life, liberty, and property by using lawful force against aggressive and criminal actions. Government would discipline the anti-social, but otherwise let people alone. The law was to apply equally to all; justice was to be impartial and even-handed.

Along with the words Life, Liberty, and Property, the word Equality has a prominent place in the political vocabulary of American thought.

The Reverend Mr. Opitz is a member of the staff of The Foundation for Economic Education, a seminar lecturer, and author of the book, Religion and Capitalism: Allies, Not Enemies.

Our Declaration of Independence reads: "We hold these truths to be self-evident, that all men are created equal." Note well that the men who prepared this document did not say that all men *are* equal; they did not say that all men are born equal or *should be* equal, or are *becoming* equal. These several propositions are obviously untrue. The Declaration said: "*created* equal." Now, the created part of a man is his soul or mind or psyche. Man's body is compounded of the same chemical and physical elements which go into the makeup of the earth's crust, but there is a mental and spiritual essence in man which sets him apart from the natural order. Man alone among the creatures of earth is created in God's image—meaning that man has free will, the capacity to order his own actions, and so become the kind of person God intends him to be.

The political theory enunciated in the Declaration is based upon certain assumptions about human nature and destiny which were ingredients of the religion professed by our forebears. It was an article of faith in the religious tradition of Christendom—a culture compounded of Hebraic, Greek, and Roman elements—that man is a created being. To say that man is a created being is to affirm that man is a work of divine art and not a mere accidental by-product of physical and chemical forces. Man is God's property, said John Locke, because He made us and the product belongs to the producer. As an owner, God cares for that which belongs to Him. Therefore, the soul of each person is precious in God's sight, whatever the person's outward circum-

stances. "God is no respecter of persons." (Acts 10:34) He ". . . makes His sun to rise on good and bad alike, and sends the rain on the honest and dishonest." (Matt. 5:45) Equality before the law is the practical application of this understanding of the nature of the human person. Equal justice means that a nation's laws apply, across the board, to all sorts and conditions of men, regardless of race, creed, color, position, pedigree, income, or whatever. In the eyes of the law, all are alike.

But right there the likeness ends; human beings are different and unequal in every other way; they are male and female, in the first place—and they are tall and short, thick and thin, weak and strong, rich as well as poor, and so on. They are equal in one respect only; they are on the same footing before the law. Equality before the law is the same thing as political liberty viewed from a different perspective; it is also justice—a regime under which no man and no order of men is granted a political license issued by the State to use other men as their tools or have any other legal advantage over them. Given such a framework in a society, the economic order will automatically be free market, or capitalistic. (We are speaking now of the idea of equality in a political context. Later I shall deal with the opposing concept of economic equality, which is incompatible with limited government and the free market.)

Political Equality

Political equality is the system of liberty, and its leading features are set forth in Jefferson's First Inaugural Address: "Equal and exact justice to all men, of whatever state or persuasion, religious or political; peace, commerce, and honest friendship with all nations,—entangling alliances with none. . .freedom of religion, freedom of the press; freedom of person under the protection of the habeas corpus" and so on.

The idea of political equality—equal justice before the law—is a relatively new one. It did not exist in the ancient world. Aristotle opened his famous work entitled *Politics* with an attempted justification of slavery, concluding his argument with these words: "It is clear, then, that some men are by nature free, and others slaves, and that for these latter slavery is both expedient and right."

Plato conceived the vision of a society constructed like a pyramid. A few men are at the top wielding unlimited power; then descending levels of power—the men on each level being bossed by those above and bossing, in turn, those below. On the bottom are the slaves, who outnumber all the rest of society. Plato knew that those in the lower ranks would be discontented with their subservient position, so he proposed a myth to condition them with—in his words—a "noble lie," or an "opportune falsehood." "While all of you in the city are brothers, we will say in our tale, yet God in fashioning those of you who are fitted to hold rule mingled gold in their generation . . . but in the helpers silver, and iron and brass in the farmers and other craftsmen." You know darn well that fraudulent theories of this sort are invented by men who suspect gold in their own makeup!

Hinduism, with its system of castes, provides a contemporary example of a system of privilege. Men are born into a given caste, and that's where they stay; that's where their ancestors were, and that's where their descendents will be. There is no ladder leading from one level in this society to any of the others. Hinduism justifies these divisions between men by the doctrine of reincarnation, arguing that some are suffering now for misdemeanors committed during a previous existence, while others are being rewarded now for earlier virtue. This outlook breeds fatalism and social stagnation. The eminent Hindu philosopher and statesman, S. Radhakrishnan, defends the caste system with a metaphor. He likens society to a lamp and says, "When the wick is aglow at the tip the whole lamp is said to be burning."

Politics—it must be emphasized—rests upon certain assumptions in basic philosophy. We of the West make different philosophical assumptions than do Greek and Hindu philosophers, for we have a different religious heritage than they. The fountain source of the religious heritage of Christendom is, of course, the Bible. The Bible was the textbook of liberty for our forebears, who loved to quote such texts as "Where the spirit of the Lord is, there is liberty," (2 Cor. 3:17) and, "You shall know the

truth, and the truth shall make you free." (Jn. 8:32) And they turned often to the Old Testament prophets with their emphasis on justice and individual worth.

Let me quote a few lines from an unsigned editorial appearing in the magazine *Fortune* some years ago:

> The United States is not Christian in any formal sense, its churches are not full on Sundays and its citizens transgress the precepts freely. But it *is* Christian in the sense of absorption. The basic teachings of Christianity are in its bloodstream. The central doctrine of our political system—the inviolability of the individual—is the doctrine inherited from 1900 years of Christian insistence upon the immortality of the soul.

It takes a while, centuries sometimes, for a new idea about man to seep into the habits, laws, and institutions of a people and shape their culture. It was not until the eighteenth century that Adam Smith came along and spelled out a system of economics premised on the freely choosing man. Smith referred to his system as "the liberal plan of equality, liberty and justice." The European society of Smith's day was, by contrast, a system of privilege; it was an aristocratic order.

The Rise of Aristocracy

England's aristocratic order did not rise by accident; it was imposed by a conqueror. England's social structure may be traced back to the battle of Hastings in 1066 and the Norman invasion of England. William of Normandy had a claim, of sorts, to the British throne, a claim which he validated by conquering the island. Having established his overlordship of England he parceled out pieces of the island to his followers as payment for their services. In the words of historian Arthur Bryant, "William the Conqueror kept a fifth of the land for himself and gave one-quarter to the Church. The remainder, save for an insignificant fraction, was given to 170 Norman and French followers—nearly half to ten men."[1] In other words, 55 per cent of the territory of England was divided among 170 men, ten of whom got the lion's share, or 27 per cent among them, while 160 men got the rest. This redistribution of England's territory was, of course, at the expense of the Anglo-Saxon residents who were displaced to make room for the new owners. The new owners of England from William on down were the rulers of England; ownership was the complement of their rulership, and the wealth they accumulated sprang from their power and their feudal privileges and dues.

Norman overlordship was a system of privilege. That is to say, the Norman rulers did not obtain their wealth by satisfying consumer demand. Under the system of liberty, by contrast, where the economic arrangements are free market or capitalistic, the only way to make money is to please the customers. Under the various systems of privilege you make money by pleasing the politicians, those who hold power. Either that, or you wield power yourself.

This was a fine system—from the Norman viewpoint; but the Anglo-Saxon reduced to serfdom viewed the matter quite differently. It was obvious to the serf and the peasant that the reason why they had so little land was because the Normans had so much and, because wealth flowed from holdings of land, the Anglo-Saxons reasoned correctly that they were poor because the Normans were rich! It is always so under a system of privilege, where those who wield the political power use that power to enrich themselves economically, at the expense of other people. It makes little difference whether the outward trappings of privilege are monarchical, or democratic, or bear the earmarks of *1984;* in a system of privilege, *political power is a means of obtaining economic advantage.*

When our forebears wrote that "all men are created equal," they threw down a challenge to all systems of privilege. They believed that the law should keep the peace—as peacekeeping is spelled out in the old-fashioned Whig-Classical Liberal tradition, as liberty and justice for all. This preserves a free field and no favor—which is the real meaning of laissez faire—within which peaceful economic competition will occur. The term laissez faire never meant the absence of rules; it doesn't imply a free-for-all. Government, under laissez faire, does not intervene positively to manage the affairs of

men; it merely acts to deter and redress injury —as injury is spelled out in the laws. This is the system of liberty championed by present-day exponents of the freedom philosophy—whether they call themselves Libertarians, or Conservatives, or Whigs, or whatever.

The Wealth of Nations

Adam Smith's "liberal plan of equality, liberty and justice" was never practiced fully in any nation, but what was the result of a partial application of the ideas of *The Wealth of Nations*? The results of abolishing political privilege in Europe and starting to organize a no-privilege society with political liberty and a market economy were so beneficial that even the enemies of liberty pause to pay tribute.

R. H. Tawney, one of the most gifted of the English Fabians, was an ardent socialist and egalitarian. His most famous work is *Religion and the Rise of Capitalism,* but in 1931 he wrote a book entitled *Equality,* arguing, in effect, that no one should have two cars as long as any man was unable to afford even one. He wished to take from those who have and give to those who have not, in order to achieve economic equality. But he acknowledged that there was an earlier idea of equality—equal treatment under the law. Here is what Tawney writes about the beneficial results of the movement toward political liberty and the free economy in the early decades of the nineteenth century, the movement known as Classical Liberalism:

> Few principles have so splendid a record of humanitarian achievement . . . . Slavery and serfdom had survived the exhortations of the Christian Church, the reforms of enlightened despots, and the protests of humanitarian philosophers from Seneca to Voltaire. Before the new spirit, and the practical exigencies of which it was the expression, they disappeared, except from dark backwaters, in three generations. . . . It turned [the peasant] from a beast of burden into a human being. It determined that, when science should be invoked to increase the output of the soil, its cultivator, not an absentee owner, should reap the fruits. The principle which released him he described as *equality, the destruction of privilege.*[2]

Smith's "liberal plan of equality, liberty and justice"means the practice of political liberty. Now, when people are free politically and legally equal, there will still be economic inequalities. There will continue to be rich and poor, as there have been wealth differentials in every society since history began. But now there's this difference: in the free economy the wealthy will be chosen by the daily balloting of their peers in the marketplace, and the wealthy won't necessarily be the powerful, nor will the poor necessarily be the weak.

Variation is a fact of life; individuals differ one from another. Some are tall and some are short; some are swift and some are slow; some are bright and others are not so bright. The talents of some lie along musical lines, others are athletes, a few are mathematical wizards. Some people in every age are highly endowed with a knack for making money; whatever the circumstances, these people have more worldly goods than others.

Rich and poor are relative terms, but every society reveals a population distribution ranging from opulence to indigence. This occurs under monarchies, and it occurs in primitive tribes which measure a man's wealth by cattle and wives; it occurs in communist states where, as Milovan Djilas pointed out in a famous book, a "new class" emerges out of the classless society, and the "new class" enjoys privileges denied the masses.

Under the system of liberty, the free market will reward men in differing degrees so that some men will make a great deal of money while others, such as teachers and preachers, have to get by on a very modest income. But under the system of liberty even those in lower income brackets enjoy a relatively high standard of living, and, furthermore, the practice of the Rule of Law guarantees that there'll be no persecution for deviant intellectual and religious beliefs. The government does not try to manage the economy or control the lives of the citizens; it keeps out of people's way—unless rights are violated.

Under conditions of political equality—which is the system of liberty, with the Rule of

Law and the market economy—a man's income depends upon his success at pleasing consumers, at which game some people are much more successful than others. A certain American entertainer earned millions of dollars last year by gyrating and howling in public places. He didn't get any of my money, and except for the fact that I believe in liberty, I might have paid a substantial sum to keep him permanently tranquilized! On a somewhat higher level, there are talented people who are sensitive to consumer demand, and so they produce the kinds of goods or render the kinds of services that people will be able and willing to buy. They'll make a bundle, in virtue of their ability to attract customers in free market competition.

Our own country's past affords the best example of the enormous multiplication of wealth—broadly shared—which results from the release of human creativity under a system of liberty. But reintroduce a system of privilege, and dreams of prosperity fade.

Helping the Poor

The big domestic issue is poverty. Ever since New Deal days in the 1930s, governments have legislated various welfare schemes designed ostensibly to help "the poor," spending trillions of dollars in these efforts. And the big issue is still poverty! It's only the relative prosperity of the private sector, working against politically imposed obstructions, which has provided the funds to fuel the futile political programs touted as the remedy for economic distress. These are false remedies. The truth of the matter is that only economic action can produce the goods and services whose lack is indigence and destitution. Misguided political programs actually manufacture poverty by hampering productivity. Should we trust further government interventions to correct the very conditions government has caused by its earlier interventions?

Poverty may be measured in various ways, but whatever else it is, poverty means a lack of the things which sustain life at the basic level, or not enough of the things which make life pleasant and enjoyable. A genuinely poor person in the United States lives in a shabby room, dresses in hand-me-down clothing, and eats meals running heavily to starchy food, with little meat and fruit. A person who is this poor would be better off if he enjoyed a larger and finer house, had several extra suits, and ate tastier and more nourishing food. After improving the situation at the level of necessities he'd move ahead to the amenities: to recreation, a second car, air conditioning, and so on. The point to note is that people move away from poverty and toward prosperity only as they command more economic goods, more of the things which are manufactured, grown, transported, or otherwise produced.

Poverty is overcome by production, and in no other way. Therefore, if we are seriously concerned with the alleviation of poverty, our concern for increased production must be equally serious. This is simple logic. But look around us in this great land today and try to find anyone for whom increased productivity is a major goal. There are some able production men in industry, but many established businesses have learned to live comfortably with restrictive legislation, government contracts, the foreign aid program, and our international commitments. The competitive instinct burns low, and the entrepreneur who is willing to submit to the uncertainties of the market is a rare bird. And then there are the farmers. Agricultural production has taken a great leap forward in recent years, but no thanks to those farmers who latch onto the government's farm program and accept payment for keeping land and equipment idle. Union leaders claim to work for the betterment of the membership, but no one has ever accused unions of a burning desire to be more productive on the job. Politicians are not interested in increased industrial or agricultural production, which is why government welfare programs manufacture poverty, and the economic well-being of the nation as a whole sinks below the level of prosperity a free market economy would achieve.

Confirmation of this point comes from a *New York Times Magazine* article by the celebrated economist, Thomas Sowell:

> To be blunt, the poor are a gold mine. By the time they are studied, advised, experimented with and administered, the poor have helped many a middle class liberal to achieve afflu-

ence with government money. The total amount of money the government spends on its anti-poverty efforts is three times what would be required to lift every man, woman, and child in America above the poverty line by simply sending money to the poor.

An overall increase in the output of goods and services is the only way to upgrade the general welfare, but there is no clamor on behalf of increased productivity. The clamor is for redistribution, for political interventions which exact tribute from the haves and bestow largesse on the have-nots. Present-day politics is based on the redistributionist principle: taxes for all, subsidies for the few.

I'm arguing on behalf of a philosophy of government which understands the primary function of the Law as the defense of the life, liberty, and property of all persons alike. Such a political establishment leads to the kind of society in which bread and butter issues are handled by the market. So now, a few words about the nature of the market.

The market is not a magic instrumentality which comes up automatically with the right answer for every sort of question. The market is a sort of popularity contest; the market tells us what people like well enough to buy; it's an index of their preferences. Thus, the market provides a very valuable piece of information, but it's far from the whole story. It's important for a manufacturer to project an accurate guess as to where the hemline will be next season, or what people will look for when the new car models are unveiled. But a similar fingering of the popular pulse is an abomination in the intellectual and moral realms—unless one is a liberal intellectual! I refer to the proclivity of the current crop of liberal opinion molders to ask: "What's going to be the fashion in ideas next season?" One glaring example of this—a former professor of mine was a leading clerical spokesman for involving the United States in World War II; but when the climate of opinion changed he became a co-chairman of SANE. This man has a good market in the intellectual realm, but of course he opposes the market in the economic realm!

The market is not some entity; the market is only a word describing people freely exchanging goods and services in the absence of force and fraud. The market is the only device available for serving our creaturely needs while conserving scarce resources. But the market is no gauge of the validity of ideas. The market measures the popularity of an idea or a book or a system of thought, but not its truth or worth. Mises and Hayek are, for my money, far better thinkers and economists than Samuelson and Galbraith; but the market for the services of the latter pair is enormously greater than the popular demand for Mises and Hayek. Likewise in aesthetic questions. An entertainer's popularity is no index of his musicianship, and a best-selling novel may fall far short of the category of literature.

The Market as Mirror

The market is simply a mirror of popular preferences and public taste; but if we don't like what the mirror reveals we won't improve the situation by throwing rocks at the glass! There is a great deal more to life than pleasing the customer, but if the integrity of the market is not respected, consumer choice is impaired and some people are given a license to foist their values on others. Permit this kind of poison to infect economic relationships and our ability to resist it elsewhere is seriously weakened.

We are throwing rocks at the mirror whenever we undertake programs of social leveling, aimed at economic equality. The government promises to aid the poor by redistributing the wealth. This, of course, is a power play, and it is the poor—generally the weakest members of a society—who are hurt first and most in any power struggle. Furthermore—and this is an important point—economic inequalities cannot be overcome by coercive redistribution without increasing political inequalities. Every form of political redistribution widens power differentials in society; officeholders have more power, citizens have less; political contests become more intense, because the control and dispersal of great amounts of wealth are at stake.

Every alternative to the market economy—call it socialism or communism or fascism or whatever—concentrates power over the life and livelihood of the many into the hands of the

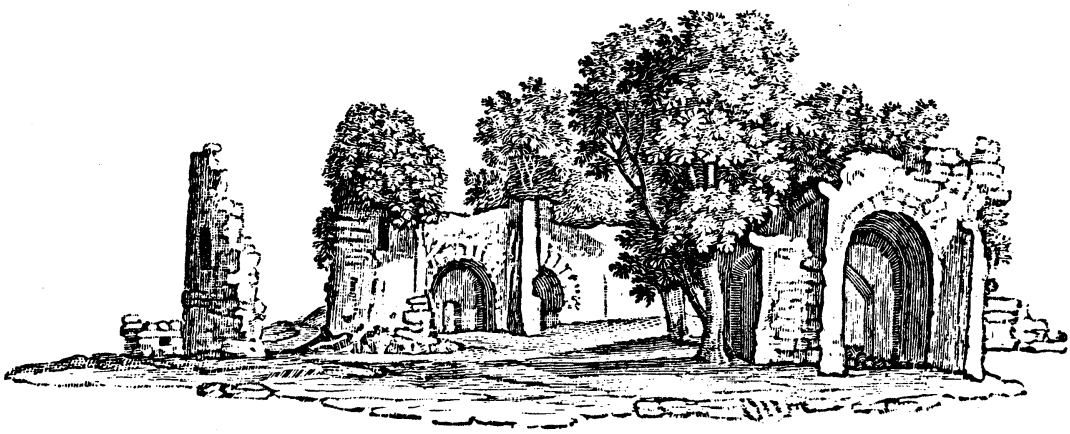
few who constitute the State. The principle of equality before the law is discarded—the Rule of Law is incompatible with any form of the planned economy—and, as in the George Orwell satire, some people become more equal than others. We head back toward the Old Regime—the system of privilege.

Those who have assumed or seized power to take from the "haves" and give to the "have-nots" will eventually realize that they are operating a dumb racket. The "have-nots" who may be on the receiving end at the beginning are generally not society's best and brightest, not the kind of people the power brokers like to hobnob with. The politically powerful who operate the transfer system will—when the light dawns—continue to plunder the "haves" but will then divvy up their take between themselves and the beautiful people who possess enough sensibility to realize the rightness of running a society for the benefit of such as they! The poor are squeezed out; they are worse off than before. And the nation is saddled with the "democratic despotism" predicted by Alexis de Tocqueville as far back as 1835.

Those of you who are fans of Lewis Carroll will remember his poem, "The Hunting of the Snark." Hunters pursued this strange beast, but every time they thought they had their quarry the snark turned out to be a quite different beast—a boojum! Every time a determined group of people have concentrated power in a central government to carry out *their* program, the power they have set up gets out of hand. The classic example of this is the French Revolution, which turned and devoured those who had started it. It is not so much that power corrupts, as that power obeys its own laws. Our forebears in the old-fashioned Whig-Classical Liberal tradition were aware of this, so they sought to disperse and contain power. They chose liberty. They chose liberty in full awareness that in a free society the natural differences among human beings would show up in various ways; some would be economically better off than others. But in a free society there would be no political *in*equality; everyone would be equal before the law.

The alternative to the free economy is a servile state, where a ruling class enforces an equality of poverty on the masses, and lives at the expense of the producers. To embark on a program of economic leveling, then, is like trying to repeal the law of gravity; it'll never work, and the energy we waste trying to make it work defeats our efforts to attain the reasonable goals which are within our capacity to achieve. □

1. *Story of England,* Arthur Bryant, Vol. I, p. 164.
2. *Equality,* R. H. Tawney, pp. 120-121.



Mom's Monopoly, Part I

by Susan J. Osburn

When explaining economic concepts to adolescents, we adults will be best understood if we use plenty of concrete examples from the kids' lives and surroundings. Here are some conversations that *could* have taken place between a graduate-student mother and her 14-year-old son, Sam.

Sam: Mom, I have to write a paper on economics for my social studies class. Can you explain some things to me, since you're taking that course at George Mason?

Mom: Sure. What, for instance?

Sam: Like *scarcity*. Does that mean things that are hard to find? Like, you can almost never get one of Madonna's earrings, but she dropped one at a concert and now someone's selling it for $10,000!

Mom: Well, it's a little like that, but scarcity in economics represents the whole idea that people have to exert themselves to obtain things they want; there isn't an unlimited supply that's available effortlessly. It's a general idea, meant to describe all human wants.

For example, in some ideas of heaven, it's a place where you just imagine something and you have it available. No scarcity of anything, you get it all automatically—food, the right temperature and humidity, light, clothing, free haloes, even harp entertainment. Also, people in this heaven are satisfied with what's there. They have no desire for different conditions or for rock music instead of harp music. But in real life, we have to do something like working or spending money to get what we want, and that creates an economy. In heaven there'd be no economy because there'd be no scarcity.

Sam: Sounds boring!

Mom: I see what you mean. What else do you need to know about?

Sam: *Opportunity cost.* I don't get it at all.

Mom: Well, it's the thing you have to give up whenever you choose something. It's the option you lose because of your decision. Remember when you were saving money for snow skis, but you spent some of it on other things?

Sam: Yeah—I bought that neat vest from the Banana Republic catalog!

Mom: You lost the opportunity to build up your ski account when you did that. In fact, you set back your ski purchase a whole year, didn't you?

Sam: Yeah—but I don't care. I'd rather have the vest.

Mom: You decided that the opportunity to get the vest was worth the cost you paid—I don't mean the price you paid Banana Republic, but what you took from yourself—giving up your skis for a whole year. You missed a year of skiing; now you'll never know whether you'd have had fun, or broken your leg. And that choice was up to you. The delay in your ski purchase is the opportunity cost. You could say that you also lost the chance to buy a new bicycle, or a really good dictionary. . .

Sam: I'd hate to spend my ski money on those things!

Mom: That's why neither of those things is the main opportunity cost. The skis are. You

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ranked the Banana Republic vest first, then the skis, then the other things. The option closest in your value system to the one you picked, the number two item on your list, is the primary opportunity cost. This is related to the idea of *exchange*.

Sam: I know what exchange is. The Stock Exchange! Or is it when you take things back to the store that Grandma gives you for Christmas? Or like when Bob traded me his Swiss army knife for my mini-telescope?

Mom: You're getting warmer. In economics, exchange is any transaction you make in order to get more of what you want. You can even exchange with yourself, the way you do when you take money out of your ski account and spend it at Banana Republic. You did it because you really prefer the vest, right? Over building up your account?

Sam: Yeah. All the adults are mad at me for it, but. . .

Mom: That's OK. This is an example. When you traded your mini-telescope to Bob, why did you do it?

Sam: His Swiss knife was so neat! It had a corkscrew, and. . .

Mom: Better than your telescope, right?

Sam: Definitely. Bob was dumb to trade it.

Mom: Then why *did* he trade it, if his knife was better than what he was getting?

Sam: He really wanted a telescope. He just felt that way.

Mom: So each of you thought you were getting something better. In every exchange between two parties, each person expects that what he's getting will please him more than what he's giving up.

Sam: I get it! But now this is really hard. *Marginal utility* and *diminishing marginal utility*. . .

Mom: No, it's not so hard. If you have a lot of something, marginal utility is the value, to you, of the piece of that something you just acquired. The unit, you would say, you last added to your stock. You know those wild tropical shirts you wear, with all the leaves and flowers and bright colors?

Sam: Yeah! I've finally got enough of them!

Mom: What happened when you only had one?

Sam: I was so glad to have it, and it was so special, I saved it to wear to the fair and the rock concert.

Mom: What happened when you got another shirt?

Sam: I wore it just to go out for burgers.

Mom: And another shirt?

Sam: I wore it just to go to Bob's house on my bike. Because I didn't care if I sweated on it, since I have others.

Mom: Did you get still another shirt?

Sam: Yeah, the one with the little guys and the canoes and palm trees.

Mom: Didn't I see you wearing that one to cut the grass?

Sam: Uh-huh. And then I put it in the wash afterwards, because even if it fades or something, I still have the other shirts.

Mom: OK. That last shirt you got is less important to you than the others, even though it's just as much in style, because you have several shirts now. You know that when you have someplace important to wear a shirt, like the fair, you'll always have one. When you had only one, it was so special and valuable that you'd hardly touch it, but by the time you got your fourth shirt, you used it for lawn-mowing duty.

The reason you valued the fourth shirt less was the rule of diminishing marginal utility. Each shirt is a unit you acquire, and the value of each unit is shown by the least significant use you make of it, which is usually determined by your total stock of that item. The more you have, the less you care about each one you get. That's all there is to it!

Sam: Economics is easier than I thought. I thought it was all about taxes and big companies.

Mom: You've been practicing economics, kid, ever since you decided to throw your food off the high chair and watch it fall rather than eat it.

Sam: Uh, thanks, Mom. I gotta go change shirts; I'm going to write my essay at Bob's house. □

Next month, in part II of "Mom's Monopoly," Sam and his mother discuss prices and entrepreneurship.

Entrepreneurs and the State

by Burt Folsom

The big story in the U.S. auto industry during 1987 was the sharp growth (+35%) in sales for Honda and the decline (−23%) for Chrysler. While Honda sold cars as fast as it could make them, Chrysler struggled with a huge backlog of 1987 models. These results should not surprise us—they are part of a long historical pattern: federally aided companies, like Chrysler with its federally guaranteed loans, rarely outperform those that have to succeed on their own merits.

Those risk-takers who have sought and received help from the state we will call political entrepreneurs; those who have succeeded without it we will call market entrepreneurs. In steamships and railroads, two of the largest industries in the U.S. during the 1800s, these two groups of entrepreneurs regularly clashed, just as they do today.

Almost from the time of the first trans-Atlantic voyage by steam in the 1830s, the governments of England and the United States subsidized steamship travel. Samuel Cunard, a political entrepreneur, convinced the English government to give him $275,000 a year to run a biweekly mail and passenger service across the Atlantic. Cunard charged $200 per passenger and 24 cents a letter, but still said that he needed the annual aid to cover his losses. He contended that subsidized steamships gave England an advantage in world trade and were a readily available merchant marine in case of war. Parliament accepted this argument and increased government aid to the Cunard Line throughout the 1840s.

Soon, Edward Collins, a political entrepreneur across the ocean, began using these same arguments for Federal aid to the new U.S. steamship industry. He said that America needed subsidized steamships to compete with England, to create jobs, and to provide a military fleet in case of war. If the government would give him $3 million down and $385,000 a year, he would build five ships, deliver mail and passengers, and outrace the Cunarders from coast to coast.

Congress gave this money to Collins in 1847, but he built four enormous ships (not five smaller ships as he had promised), each with elegant saloons, ladies' drawing rooms, and wedding berths. He covered the ships with plush carpet and brought aboard olive-wood furniture, marble tables, exotic mirrors, painted glass windows, and French chefs. Collins stressed luxury, not economy, and his ships used almost twice the coal of the Cunard Line. He often beat the Cunarders across the ocean by one day, but his costs were high and his economic benefits were nil.

With annual government aid, Collins had no incentive to reduce his costs from year to year. He preferred to compete in the world of politics for more Federal aid than in the world of business against price-cutting rivals. In 1852 he went to Washington and lavishly entertained

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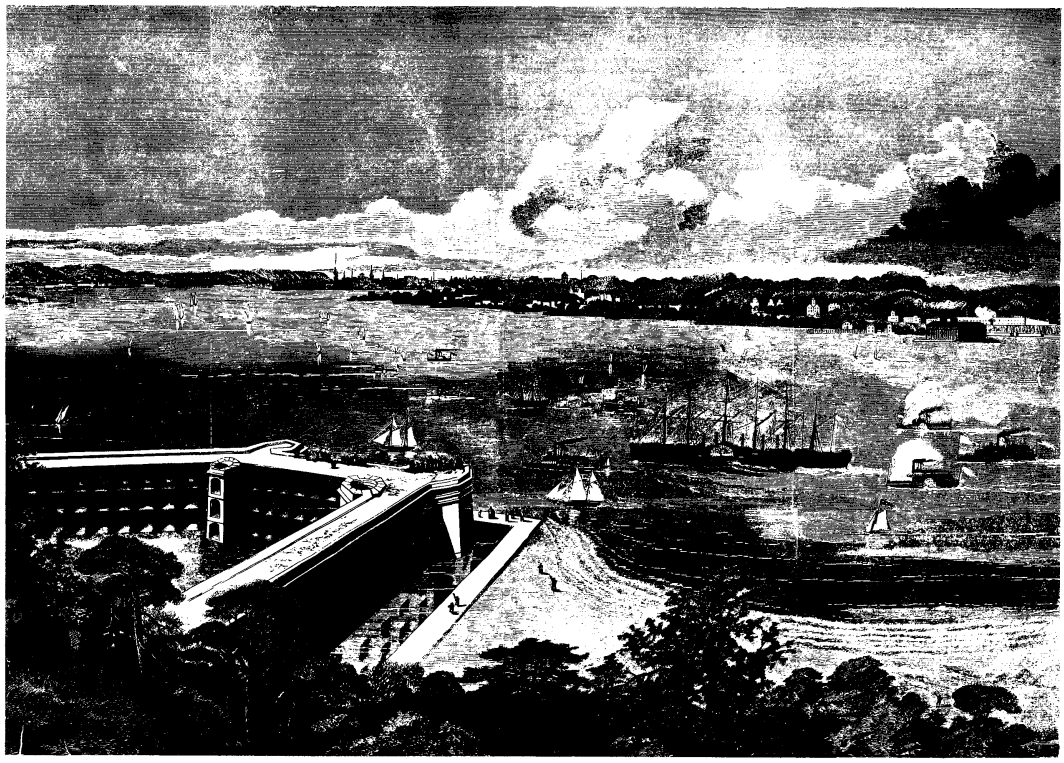


New York Harbor in the mid-1800s.

President Fillmore, his cabinet, and influential Congressmen. Collins artfully lobbied Congress for an increase to $858,000 a year.

It took Cornelius Vanderbilt, a New York shipping genius, to challenge this system. In 1855, Vanderbilt offered to deliver the mail for less than half of what Collins was getting. Congress balked—it was pledged to Collins—so Vanderbilt decided to challenge Collins even without a subsidy. "The share of prosperity which has fallen to my lot," said Vanderbilt, "is the direct result of unfettered trade, and unrestrained competition. It is my wish that those who are to come after me shall have the same field open before them."

Vanderbilt's strategy against Collins was to cut the standard first-class fare to $80. He also introduced a cheaper third-class fare in the steerage. The steerage must have been uncomfortable—people were practically stacked on top of each other—but for $75, and sometimes less, he did get newcomers to travel.

Vanderbilt also had little or no insurance on his fleet: he built his ships well, hired excellent captains, and saved money on repairs and insurance. Finally, Vanderbilt hired local "runners" who buttonholed all kinds of people to travel on his ships. These second- and third-class passengers were important because all steamship operators had fixed costs for each voyage. They had to pay a set amount for coal, crew, maintenance, food, and docking fees. In such a situation, Vanderbilt needed volume business and sometimes carried over 500 passengers per ship.

All this was too much for Collins. When he tried to counter with more speed, he crashed two of his four ships, killing almost 500 passengers. In desperation he spent one million dollars of government money building a gigantic replacement, but he built it so poorly that it could make only two trips and had to be sold at more than a $900,000 loss.

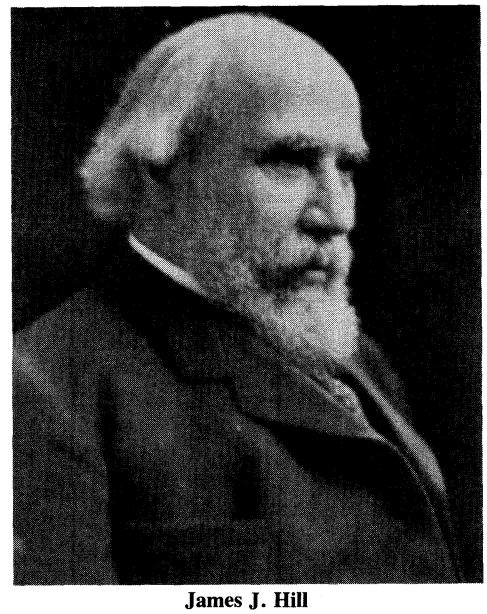
Finally, Congress was outraged. Senator Robert M. T. Hunter of Virginia said: "The whole system was wrong . . . it ought to have been left, like any other trade, to competition." Senator John B. Thompson of Kentucky concurred: "Give neither this line, nor any other line, a subsidy. . . . Let the Collins Line

die. . . . I want a tabula rasa—the whole thing wiped out, and a new beginning.'' Congress voted for this ''new beginning'' in 1858: they revoked Collins' aid and left him to compete with Vanderbilt on an equal basis. The results: Collins quickly went bankrupt, and Vanderbilt became the leading American steamship operator.

And there was yet another twist. When Vanderbilt competed against the English, his major competition did not come from the Cunarders. The new unsubsidized William Inman Line was doing to Cunard in England what Vanderbilt had done to Collins in America. The subsidized Cunard had cautiously stuck with traditional technology, while William Inman had gone on to use screw propellers and iron hulls instead of paddle wheels and wood. Inman's strategy worked; and from 1858 to the Civil War, two market entrepreneurs, Vanderbilt and Inman, led America and England in cheap mail and passenger service. The mail subsidies, then, ended up retarding progress: Cunard and Collins both used their monopolies to stifle innovation and delay technological changes in steamship construction.

Unfortunately, this cycle of government subsidy, mismanagement, and bankruptcy repeated itself a few years later in the railroad industry. With California and the Rocky Mountains safely in the Union, some people wanted a transcontinental railroad to tie the country together. Political entrepreneurs of the day convinced Congress that without Federal aid the nation could not be linked by rail. Most historians have bought this argument, too. The late Thomas Bailey, whose textbook, *The American Pageant,* has sold over two million copies, said, ''Transcontinental railroad building was so costly and risky as to require government subsidies.'' Congress adopted this logic and gave almost 100 million acres and $61 million in Federal loans to four transcontinentals.

With massive Federal aid came unprecendented corruption. The Union Pacific and Central Pacific built shoddy lines very quickly just to capture the Federal subsidies. Also, the Credit Mobilier scandal, in which Union Pacific officials bribed Congressmen with cheap stock in return for favorable votes, rocked the Grant administration and branded the whole railroad industry as corrupt. Eventually, negative public reaction helped lead to the establishment of the Interstate Commerce Commission. Congress, in effect, said that Federal regulation was the solution to the problems created by Federal aid.



James J. Hill

Fortunately, James J. Hill, a market entrepreneur, showed the country how to build a different kind of transcontinental. From 1879 to 1893 he built the Great Northern Railroad from St. Paul to Seattle with no Federal subsidy. Slowly, methodically, and with the best technology of his day he built a model line—relatively straight, on an even grade, and with high quality steel. He made each piece pay for itself before he moved further west. During the depression of the 1890s, when the subsidized Union Pacific, Northern Pacific, and Santa Fe Railroads went bankrupt, Hill ran his line profitably each year.

State aid—and this includes tariffs as well as loans—is always well intentioned. From Collins to Iacocca those who seek such aid really believe they have their nation's best interest at heart: they are protecting jobs, helping local industries compete, and preserving the industrial future of the nation. It is sad to see the opposite so often happen. Chrysler did pay back its loans—but it appears to be following the historical pattern set long ago in steamships and railroads. □

The Myth of Japanese Industrial Policy

by C. Brandon Crocker

Record trade deficits and the fear that America is losing its manufacturing base have focused attention on the need to restore American competitiveness. One proposed solution, which is making its way toward the political front burner, is "industrial policy"—government intervention in specific sectors of the economy geared toward "improving the patterns of our investments."[1]

This idea last came to the fore when Walter Mondale adopted it in his 1984 presidential bid. Although the term "industrial policy" is somewhat vague, and is used to mean different things by different people, it usually encompasses some form of government intervention aimed at specific industries. Such intervention ranges from subsidies or tax breaks to government-financed employee training programs.

It is incumbent upon industrial policy proponents to answer three questions: First, under ideal circumstances, can industrial policy work? Second, in the real political world, will industrial policy degenerate into yet another means for politicians to pass pork-barrel legislation? And third, is the sacrifice of individual liberty involved in implementing a serious industrial policy worth the supposed gains? This article is concerned with the first two questions, for if the advocates of industrial policy fail on these two points, the last question is moot.

Proponents of national industrial policy often point to Japan as a showcase of what such policies can do. The Japanese government, through such agencies as the Ministry of International Trade and Industry (MITI) and the Ministry of Finance, has played a powerful role in the economy, the argument goes, turning a war-battered Japan into an economic juggernaut in 25 years. The reality of the Japanese experience, however, does not provide support for a U.S. industrial policy.

During the 1950s and 1960s, the Japanese banking system wasn't well developed, nor did Japanese companies have access to an efficient capital market. This enabled the government, mainly through the Ministry of Finance and the Bank of Japan, to influence the availability of funds to specific industries. The government controlled a vast pool of private savings deposited with the post office, which had a virtual monopoly on private savings deposits.

With this power, the Japanese government effectively rationed credit, giving greater amounts to targeted industries such as steel, utilities, and communications. As domestic credit markets matured, however, and Japanese firms expanded and were able to tap foreign capital markets, the Japanese government lost the ability to control the flow of capital. Nevertheless, the government still controls a substantial amount of private savings which it uses for subsidized loans and loan guarantees.

MITI has long tried to influence company policies, while attempting to coordinate some industry activities, such as research and development. This role has grown in importance as credit rationing is no longer practicable. MITI has also loosened antitrust laws to allow firms to engage in joint research activities and to

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permit firms in troubled industries to cooperate.

However, the fact that a government has attempted to play an active role in an economy does not necessarily mean that it has significantly altered the final workings of the market. This seems to be the case in Japan.

During the 1950s and 1960s, when the Japanese government used credit rationing to allocate capital to target industries, Japan was rebuilding its industrial infrastructure which had been battered during the war. This made it relatively easy to see which industries needed to be developed in order to catch up with other industrialized countries. A private commercial banking system, however, probably would have targeted these same industries since they offered profitable returns at low risk. But even if the government's efforts at targeting industries after World War II hastened Japan's economic rebirth, such a policy would not be relevant to an already developed economy such as the United States in 1988.

MITI's Overstated Influence on Japanese Firms

MITI's influence over Japanese businesses is often overstated. Japanese firms generally follow only the MITI proposals with which they concur. MITI, for instance, did not want Mitsubishi and Honda to build cars, and did not want Sony to purchase U.S. transistor technology. The companies, however, went ahead, and entire industries were transformed.

MITI has not had any real power over Japanese industry since the Japanese government lost its near monopoly on the supply of credit in the early 1970s. Since then, MITI has made only suggestions, or has ruled on proposals from business leaders concerning industry cooperation and government loans. As Sadanori Yamanaka, Minister of International Trade and Industry, stated in 1983, "MITI works in an indirect fashion. When it guides industry, it is with soft hands. It has no real coercive power anymore. The main player is private industry."[2]

The savings still controlled by the Japanese government are spread so thin among special interests that they are not an effective tool for industrial policy. Charles Schultze, chairman of the Council of Economic Advisors under President Carter, has concluded, "In Japan as in any other democratic country, the public investment budget has been divvied up in response to diverse political pressures. It has not been a major instrument for concentrating investment resources in carefully selected growth industries."[3]

A case in point is semiconductors. This industry has been lauded as an example of the successful use of government financing for research and development. Yet the government's main investment arm, the Japanese Development Bank, has spent only one per cent of its budget for semiconductor research and development, which represents only a few percentage points of total research and development in the industry.[4]

In addition to being spread thin, Japan's public investment budget is relatively small. During the 1970s, net lending by the Japan Development Bank amounted to only one per cent of private non-housing capital formation.[5] The Japanese government is responsible for about 28 per cent of its nation's non-defense research and development—four per cent *less* than what the U.S. government supplies.[6] Far from being an aggressive partner in funding industrial research and development, the Japanese government is actually *less* active than is the U.S. government.

One true success story of Japan's industrial policy has been the government's ability to assist distressed industries. The Japanese government has achieved this by relaxing antitrust laws so that firms can work together in industries burdened by over-capacity and reduce research and development expenditures by entering into joint research projects. But this is not an argument for an increased government presence in the market; it is quite the opposite. The success of this policy comes from *reducing* government intervention.

Though the extent of Japanese industrial policy has been exaggerated, it cannot be denied that it has had some effect on the Japanese economy during the past 35 years. There is no convincing evidence, however, of a causal relationship between industrial policy and Japan's economic success. In fact, the argument could be made that the Japanese economy

WIDE WORLD PHOTOS

"The two industries most associated by Americans with Japanese success—automobiles and consumer electronics—were never selected by the Japanese government as priority industries."

has flourished *despite* the activities of agencies such as MITI.

Aside from targeting basic industries after World War II, the performance of Japan's economic planners has left much to be desired, by the planners' own standards. In contrast to the examples of Mitsubishi, Honda, and Sony, which had the determination and foresight to disobey MITI, some of Japan's big industrial disappointments such as shipbuilding and aerospace received much government favor and funding. The Japanese cement, paper, glass, bicycle, and motorcycle industries—all of which are success stories—never received much assistance, and occasionally encountered some resistance from MITI. The two industries most associated by Americans with Japanese success—automobiles and consumer electronics—were never selected by the Japanese government as priority industries.

The Japanese economy has benefited from a number of factors since the early 1950s, none of which have had anything to do with industrial policy.

First, encouraged by low tax rates (especially on interest income, which for most individuals is tax-free) and the absence of a social security system, the Japanese have saved at a high rate. Over the past 25 years, the Japanese individual savings rate has ranged between 17 per cent to more than 20 per cent of after-tax income; over the same period Americans saved only four to seven per cent.[7]

Second, the Japanese have had access to relatively cheap labor until recently, as economic growth has bid up wages. This labor force has a strong work ethic, with most Japanese working six-day weeks and rarely taking holidays.

Third, Japanese management has done an excellent job in controlling production costs, recognizing and meeting consumers' desires, and in formulating human resource policies which have kept worker morale and productivity relatively high, and the power of labor unions low. With so many favorable variables at work, there is little cause for hailing industrial policy as the reason for Japan's economic robustness.

Political Questions

History clearly shows that the United States government is not well suited to making hard decisions on resource allocations, separate of political considerations. Charles Schultze cites the examples of the Economic Development Administration (which categorizes fully 80 per cent of the counties in the United States as being eligible for "aid to depressed areas") and Lyndon Johnson's Model Cities program, which ended up dividing its budget among 150 cities. Government policy toward the tobacco industry, which is simultaneously taxed, restricted, and subsidized, is another indication of the government's ability to implement a consistent industrial policy. A national industrial policy would not be any different from the existing hodgepodge of politically inspired handouts, except that more special interests, and significantly more funding, would be involved.

The Japanese government no longer "targets" industries as some industrial policy proponents would like to see the U.S. government do. The reason for this has been the realization by the Japanese government that it cannot predict what the best industries will be for Japan.

Aneel Karnani, Professor of Corporate Strategy at the University of Michigan, states the issue clearly: "What will be the better growth industry in the next decade, computers or biotechnology? Do you want some bureaucrat somewhere making that decision?"[8]

Austrian economist Friedrich Hayek has provided the answer: "It is through the mutually adjusted efforts of many people that more knowledge is utilized than any one individual possesses or than it is possible to synthesize intellectually; and it is through such utilization of dispersed knowledge that achievements are made possible greater than any single mind can foresee."[9]

The market brings together the information possessed by all individuals in the market and, therefore, is able to make better decisions on questions of optimal resource allocation than can any group of bureaucrats. To try to identify "winners" and "losers" beforehand is folly.

Japan's economic success is not due to industrial policy. The Japanese success story is based on high savings, hard work, and excellent business leadership. These are the areas in which the United States must improve to remain competitive in the world market. The U.S. government can make positive contributions by reducing the budget deficit, repealing burdensome regulations, and implementing tax policies which encourage work and productive investment. But attempts at "planned" meddling will not help. □

1. Ira Magaziner and Robert Reich, *Minding America's Business* (New York: Harcourt Brace Jovanovich, 1982), p. 4.
2. Sadanori Yamanaka, quoted by Steve Lohr, "Japan's Trade Ministry Draws Praise and Ire," *The New York Times*, May 17, 1983.
3. Charles Schultze, "Industrial Policy: A Dissent," *The Brookings Review*, Fall 1983, p. 7.
4. Tom Palmer, "Chipping Away at Free Trade," *Inquiry*, November 1983.
5. David Henderson, "The Myth of MITI," *Fortune*, August 8, 1983, p. 114.
6. Sinichiro Asao, "Myths and Realities of Japan's Industrial Policies," *The Wall Street Journal*, October 24, 1983.
7. Bernard Wysocki, and Christopher Chipello, "As Americans Spend, Wary Japanese Save, and Taxes Are a Cause," *The Wall Street Journal*, August 25, 1985.
8. Aneel Karnani, Lecture on Industrial Policy, The University of Michigan Graduate School of Business Administration, April 22, 1987.
9. Friedrich Hayek, *The Constitution of Liberty* (Chicago: The University of Chicago Press, 1960), pp. 30–31.

Who Should Support the Arts?

by Melvin D. Barger

Ask who should support the arts, and the free-market answer should be obvious. *The arts should be supported by people using voluntary, peaceful means and processes.* At the same time, governments should maintain the same neutrality toward the arts that they're supposed to show toward religion and the press. This means that people in the visual and performing arts should always have a wide range of freedom in their pursuit of full self-expression. Their artistic freedom reflects the liberty any of us should have—and we should defend it. There is almost no justification for governments to shut down a play, ban a book, interfere with a concert, or forbid the display of a painting.

In that same spirit, however, we should not be moving in the opposite direction by making support of the arts a function of government. It's true that we have been on that road for a long time now. One major turning point was the establishment of the National Endowment for the Arts (NEA) in 1965. That has become a $180-million industry with Federal support. Influential voices continue to demand increases in the NEA funds along with more subsidies for the arts by state and local governments.

Any support that's given, however, is unfair to somebody and results in a misuse of public funds. Despite what its advocates claim for it, government support of the arts is also unlikely to do much for art and for artists over the long term.

Mr. Barger was a business writer associated with Libbey-Owens-Ford Company and one of its subsidiary firms for nearly 33 years. He has also appeared in more than 30 amateur plays and musicals since 1954 and had a small professional role in 1987. He is married to a commercial fashion artist, and their children have art-related educations and interests.

We should be able to understand why demands for such support are made—they are often self-seeking efforts by groups of producers and consumers hoping to gain advantages at public expense. The producers include a wide assortment of people believed to possess talent in the various branches of the arts. They are writers, playwrights, poets, painters, sculptors, dancers, singers, musicians, composers, and even architects. The consumers associated with them are people devoted to the arts, often as spectators or patrons. Allies of both groups are people who benefit from the arts—communities seeking funds, publishers, teachers, and manufacturers and vendors of supplies.

Buttressed by Shrewd Arguments

These individuals and groups shrewdly base their arguments on points that attempt to place all forms of art in the public interest. One idea is that culture makes us a better society; Federal support is needed to prevent our decline into

cultural barbarism. Another idea is that the free market fails to provide outlets for the higher forms of art. A third idea is that the United States has been deficient by lagging behind European governments which support the arts as a matter of course. There is also the myth of the starving artist— if we neglect to support the arts, we will be condemning another van Gogh or Mozart to a wretched existence. It is also generally recognized that many highly talented artists lack commercial aptitude, and this leads to an argument that the public has a responsibility to support them.

We should be careful about buying into any of these arguments. Improving society? Nobody can really show a connection between the higher forms of art and a better society. Market failure? The free market, though scorned by many artists, actually provides handsome opportunities for talented people. Support in Europe? The same European governments that support the arts have been regarded as discriminatory by many groups. Starving artists? We feel guilty about artists who were ignored in their own time, but they could continue to fall through the cracks in a system of Federal support. The personal problems that beset van Gogh and Mozart, for example, would get them in trouble with the government bureaus who administer support to artists today. The artist's lack of commercial aptitude? Well, many of us are deficient in this respect—but we cover these deficiencies by joining forces with others who possess marketing and administrative skills.

What are some of the problems inherent in government support of the arts? In most respects, the problems are similar to those of excessive government involvement in other activities that ought to be left to voluntary processes. Here are comments about a few of them:

1) *Government support of the arts must always be politicized and bureaucratized.* One of the curious contradictions of those who demand government support is that they also demand absolute freedom of expression for the artist. They abhor political controls and anything that seems to smack of government oppression. They are also likely to be free spirits who hate following procedures and obeying cumbersome rules. Even the need to prepare the necessary paperwork and compliance forms is often bitterly criticized and resented, though such procedures are a necessity under any bureaucratized system.

The artists who have expectations of support without controls do not really understand the basic nature of government as organized force. Any government, whether communist or democratic, represents political and coercive forces. All the resources and powers of the government tend to be deployed to serve the interests of the political group in control and also to deal with things that threaten the very survival of the state. This is as true of the United States as it is of the Soviet Union. Either type of government must also establish bureaus and procedures for any of its activities, whether it's running the army or supporting artists. Any decision to make something a government activity is also a decision to place it under bureaucratic management with various controls and reporting methods for measurement of results.

Control Is Logical

Artists chafe under this type of political control, but it's unavoidable if support is to come from the government. Soviet leaders have been denounced for their heavy-handed control of artists in the past, but it has been entirely logical and proper *from their point of view*. The Soviet government is criticized for expecting artists and writers to follow the party line in their work. This must always be necessary, even if the party line begins to soften in the eyes of Western observers. But even elected governments must impose "party lines" on artists who receive government support. This control in a democratic society may be hidden and indirect, but it is control nevertheless. One way it is exercised, for example, is in showing a bias for or against certain types of art or expression. Right now, for example, government support of the arts in the U.S. is supposed to favor groups considered to be disadvantaged. Laudable as this aim seems to be, it is a political response, not an objective artistic one.

Support for the arts must also be bureaucratized, subject to detailed rules and regulations. We can be sure that artists and writers in the

Soviet Union are carefully controlled and scrutinized by the government bureaucracy which dispenses largesse to them. In the same way, however, government officials in Western societies must maintain some records and controls over artistic ventures. They must follow a policy of covering their own actions at all times. Officials must always be prepared to provide answers for Congressional members to show that funds for the arts are being spent for "good public purposes." This requires record-keeping, feedback, constant reviews, and all the other tiresome processes that go along with government work.

Captive to Elitists

2) *Government support for the arts must be captive to elite groups.* One of the arguments for Federal subsidies is that the higher forms of arts do not usually have mass appeal. Why is there no mass appeal? Well, since much art is related to entertainment, this often comes down to what each of us likes to see, read, and hear while we're being entertained. The American public is often berated because many people are apparently willing to help country singers and romance writers become popular while displaying some indifference toward opera stars and serious writers. This indifference is not absolute, however, and some opera singers and serious writers do acquire a strong following.

One reason country singers and romance writers are popular is that they *try* harder to please their audiences. But creative and performing people in the so-called "higher" forms of art often convey the idea that nothing can be good if it is popular. Their work is of such high quality and meaning, they feel, that only a few people have the good sense and taste to appreciate it.

These groups of people with elitist ideas are most likely to control government programs for support of the arts. They are the ones most likely to have the required credentials and interests. The artists who have found a good market are more likely to be too busy with their own work to become involved in subsidized programs. The result is that the general public eventually is drawn to support the cultural aims and values of a small group of people.

Sometimes this group seizes control by appearing to defend the artists' freedom. The National Endowment for the Arts, for example, has "peer panels" which make grant-making decisions to take the purse strings "out of Big Brother's hands," Douglas Davis noted approvingly in *The New York Times* (October 16, 1987). But what does this do except give the peer panel members the power to become Big Brothers in their own way? Given the jealousies and rivalries among artists, there is no peer panel anywhere that can deal fairly and objectively with all groups in dispensing Federal grants.

3) *Government support of the arts is likely to be inefficient.* This is hard to prove, because there is no market test for government support of the arts. Nobody is permitted to make judgments that are in any way related to the "outputs" resulting from certain amounts of "inputs." In fact, creative people are the first to denounce any control that smacks of cost-efficiency and other measures of the marketplace.

Yet, even people devoted to the arts are finding fault with the actual results of, for one example, the 20-year funding of the National Endowment for the Arts. Hilton Kramer, a former art critic who edited an arts-centered magazine, had this to say about the NEA's performance:

"In general I would say in so far as the creative side of art is concerned—the quality of what artists in America have actually produced—the Endowment has had absolutely no discernible effect on that whatever.

"It is the institutions that have benefited from the Endowment. The greatest benefit has been enjoyed by their administrative officers. The arts bureaucracy has proliferated to an unprecedented degree."[1]

It is not surprising that most of the resources for the arts should be consumed by the managing bureaucracy instead of persons designated as recipients. This inefficiency has always been the curse of Federal programs, and newspaper writers seem to delight in pointing it out. Exposing such inefficiencies never cures the problem, though, because it always turns out that the administrative operations are necessary under the circumstances.

The Problem of Defining Art

4) *Government programs must define who is an artist.*

Who is really an artist? It's possible that this has been debated ever since artistic expressions began to emerge. In the modern world, this has led to much controversy about abstract art and the value of writing and poetry which nobody seems to understand. But under government systems, judgments have to be made.

In making these judgments, we quickly discover that it is no easy task to define who is an artist, and whose talents or potential merit aid. It often seems brutal when the market for art services rewards one person and seems to neglect another who appears to be more talented. But this brutal verdict of the market seems gentle compared with the arbitrariness public officials have to exercise in selecting those to be helped.

Who should receive help? The truth is, we have people in every society who are capable of artistic expressions. The present author knows a postman who is a gifted actor, an auto body repairman who is a fine sculptor, a salesman who possesses an outstanding baritone, and an engineer who is a painter. They found employment outside the art fields, apparently without feeling ignored or put down by society. Though gifted, they are not unusual and any community will have people with similar talents and interests.

Many Forms of Expression Available

How do these talented people express themselves? Most of them have found outlets in amateur or semi-professional activities. They are also capable people who earn a good living in other fields. Far from crippling their artistic expression, their additional work experience augments it. The sculptor, for example, acquired welding skills as an auto body repairman that gave him an advantage in creating metal forms. A number of amateur artists also sell their paintings at art exhibits or through special arrangements with clients. Singers, dancers, and actors find expression through performing groups that seem to be available in most communities. Now and then, an amateur performer moves into professional work as a result of experience gained.

We should not deplore or belittle the modest efforts of local arts programs. Gifted individuals have to start somewhere—perhaps in a community theater or a local writing club. This is the proper place to discover and develop talent. It's no different from the experience of a major league baseball player who plays his early games on sandlots, or a future National Open golf champion who learns to play on a local course. Talent will usually open its own channels of expression when people are free to choose and free to take actions in their own behalf.

Avoid the Guilt Trap

We can also be made to feel guilty about the seeming selflessness of the gifted artist—a person who places beauty and self-expression above the vulgar interests of the commercial marketplace. It artists are willing to sacrifice everything for their art, shouldn't ordinary people at least be willing to support them?

This is exactly what fine artists and their advocates want the rest of us to believe. In promoting their arguments about the special nature of the fine arts, they are all too human. It bears repeating that every group of producers and consumers seeks its own benefit. Fine artists want to benefit by creating more demand for their services, while the consumers of fine arts want to shift some of their costs to others. Public aid to the arts meets the objectives of each group and also carries the added advantage of appearing to be in the best interests of society.

Does the market ignore fine artists? The fact is, there are always markets for many talented people at various pay levels. A more serious problem is that fine artists and their supporters ignore the market, or supply their services with such cost inefficiencies that it becomes impossible to attract the right amount of voluntary support.

It has long been known, for example, that militant pressure by musicians' unions has driven up costs for symphony orchestras in the United States. The result is that admission

prices no longer cover costs for most symphony productions and private patrons are balking at further increases in support. Far from taking responsibility for this "market failure," musicians and their advocates demand increased public support to cover the cost gap! In the fall of 1987, for instance, the Detroit Symphony Orchestra became locked in a bitter labor dispute which resulted in cancelled performances. Musicians had sought a pay increase, but management insisted that orchestra survival required an 11 per cent cut in musicians' salaries which, for 91 of the 101 musicicans, were higher than the minimum $47,320.[2]

Though some scorned this level as too low for highly talented musicians, their situation is not really different from other workers, both blue-collar and professional. Highly trained and talented though we may be, the value of our services is finally decided by what people will pay for them. We become unemployed if we insist on holding our wages above what the market will bring to us. And we are on very shaky ground, indeed, when much of our "market" depends on patrons and grants in addition to ticket purchasers.

Featherbedding on Broadway

Union cost pressures have also been a major problem for many theatrical productions. A typical example of this, reported by Carol Lawson in *The New York Times* (February 19, 1982), was a requirement that 25 musicians be employed for the Broadway production of "The Best Little Whorehouse in Texas," though only nine were needed for the performance! This meant that 16 musicians were called "walkers"—people who were paid but did not perform.

Musicians are only part of the problem with soaring costs for productions. Writing in *The Wall Street Journal* (August 18, 1987), critic Manuela Hoelterhoff reviewed the expense items that raised the New York City Opera's costs to $112,452 a day. This compared with a box office gross of $63,503, even at 93.6 per cent of capacity. The cost for a stagehand's services at the opera are $80,000 a year for a regular employee and up to $150,000 for a department head. Expenses for other items including costumes and props seemed similarly out of control—but were probably justified in the thinking that has come to characterize artistic productions in New York. With revenues covering little more than half the operating costs, it's small wonder that subsidies are demanded for operatic groups.

Turning Back Is Unlikely

It's doubtful that there'll be any early retreat from the art subsidy programs now in operation. The National Endowment for the Arts, for example, is well entrenched, with allies who know how to lobby for its continued support. The other groups demanding and receiving various subsidies also know how to justify their programs.

We should keep in mind, however, that conditions of liberty are most likely to bring the greatest advances in art and artistic expressions. Artists also are more likely to thrive and produce in a society where free-market conditions are active. Though some artists resent the demands and requirements of the marketplace, the best opportunities for real improvements in the arts are provided by a wholly free market.

One of the best examples has been the high *employment* rate for talented people in the United States. The "starving artist" has been pitied, but the truth is that America offers much well-paid employment for people in various artistic professions. Writing in *The Wall Street Journal* (November 10, 1987), Economist Randall K. Filer noted that people in artistic categories earned only $750 less than the average for all U.S. workers. Beyond that, employment for artists had grown considerably between 1970 and 1980, and most artists have been able to stay in their own professions.

It's true that much of this employment is in work that is scorned by some who view it as degrading for a writer to produce advertising copy or for an illustrator to apply his talents to catalogs. In fact, however, talented people who can find these profitable outlets for their services are very fortunate—and they should reflect upon the fact that less developed societies usually have nothing to offer the artist. Even the masters of earlier times were really commercial artists—as anybody can tell by noting

that the subjects of great paintings were often members of the nobility who gave the artists employment.

Another important point is that the technological advances of a market-driven economy also benefit the artist. Thanks to many developments, artists now have materials and processes that simply did not exist 100 years ago. Photography, for example, became a new art form that branched into motion pictures and now has added expressions in video productions—all giving artists more latitude and opportunities. Technology has also created new materials for painters and sculptors, new instruments such as the Moog Synthesizer for musicians, and better methods of producing and retaining artistic work. Thanks to technology, future generations will be able to listen to our great singers and see our leading actors on the screen.

The free market also gives artists the opportunity to follow their own aspirations in seeking full expression. The diversity that characterizes the art fields is also a strength. The artist, in order to survive and become recognized, usually needs only the opportunity to seek out a small number of allies and supporters. For a painter, this might mean only a group of local admirers who are willing to buy his work. For a writer, it might mean only a few small magazines who will publish his material or perhaps a shoestring publisher who will risk the money it takes to produce and market a book. For a creative professional person like an architect, all that's required is one client who is looking for an unusual idea. There is no better example of the last than Frank Lloyd Wright's design of the famous house, "Fallingwater," in the middle of the Great Depression. There's little doubt that most builders and certainly any government agency would have scorned his concept of a cantilevered house over a waterfall—but Wright needed only the financial support and approval of his client, Edgar J. Kaufmann, to transform the idea into a spectacular artistic success.

Peaceful Means Needed

The quest of the artist always comes down to freedom of choice—and Ludwig von Mises argued that this could not be available in a socialist society. But he insisted that artists have many alternatives under capitalism—they can seek to sell their work, they can look for rich clients and patrons, or they can support themselves in other ways and pursue art avocationally. It is also possible that artists may have some difficulty along the way, but this cannot be avoided. For the artist, Mises thought, "it is impossible to smooth the way that he must tread if he is to fulfill his destiny. Society can do nothing to aid progress. If it does not load the individual with quite unbreakable chains, if it does not surround the prison in which it encloses him with quite insurmountable walls, it has done all that can be expected of it. Genius will soon find a way to win its own freedom."[3]

There is also no need to fear for the future of art or individual artists. The human impulses to express in various art forms run deep and have a long history. We know that art was already developing thousands of years ago in primitive societies of hunters and gatherers. No matter where we turn, we will find people expressing themselves as writers, as performers, and as painters and sculptors. As we continue to press ahead in technology and general work becomes easier, there will be more time for the serious artist in every field. There will also be more opportunities unfolding, just as the current century has given more artists employment than at any time in history. The more affluent we become, the more we are likely to appreciate all forms of art and to demand greater artistic expression in all things.

Who should support the arts? The arts should be supported by people using voluntary, peaceful means. All of us help support the arts when we're seeking entertainment, buying well-designed products, attending a performance, or choosing a book. It's all part of our human existence—and the best expressions of art are yet to come. The highest and finest expressions will be produced by artists who have the freedom to develop their own gifts as they will. □

1. Quoted in *The Washington Times*, September 23, 1985, in an article by Jane Addams Allen entitled "The Arts of Government." (In fairness to both Mr. Kramer and Ms. Allen, neither should be represented as supporting all the points in the present article.)

2. *The Detroit Free Press*, October 4, 1987.

3. Ludwig von Mises, *Socialism* (New Haven: Yale University Press, 1951), p. 190.

Public Funding for the Arts: Diamond or Daub?

by Eugenie Dickerson

There are things that government should never touch—religion, free press, the arts. . . . I learned how badly bureaucrats can mangle the last category when I served on an arts board, and because I respect the independence of the American mainstream to sift classical art from con art.

All across the continent, the public questions the picks of tax-funded arts boards.

New York City is the scene of bitter opposition to the sculpture "Tilted Arc." The 120-foot-long wall was hatched in the Federal Plaza in Manhattan in 1981 out of a Federal art-in-architecture grant. The General Services Administration bought the 73-ton, rusted steel sculpture for $175,000. The government has since decided to search for a more appreciative site for it.

Richard Serra, the sculptor, in turn filed suit, claiming that relocation of his work would violate his free speech right. Also involved in the suit were breach-of-contract, copyright, and trademark counts.

In August 1987, Senior U.S. District Judge Milton Pollack ruled that relocating "Tilted Arc" doesn't violate Serra's right to free speech, since the GSA owns the artwork. The other three counts were also dismissed, because of the government's sovereign immunity from these claims.

Chicago bought a huge, red-brown metalwork that looks like a woman from one angle and a horse from another. Nobody doubts that the artist had a reputation, but so did P. T. Barnum.

In Tacoma, Washington, one per cent of the cost of new public buildings and remodeling projects was set aside to be spent on public art. As decoration for their new stadium, Tacomans wound up with a string of neon lights in lopsided letters and squiggles for $272,000.

Tacomans raged. They forced the issue onto the ballot and voted 3 to 1 a recommendation that the work be removed. In a reverse type of censorship, the officials claimed the public needed a visual challenge and the thing would stay no matter what the tastes of the public.

But the people *really* hated the lights. Another drive was undertaken, this one to withdraw the one per cent of capital improvement funds earmarked for the arts. This vote was binding and successful.

The neon lights remain today, but the bureaucrats haven't money to buy more kitsch. The Tacoma City Council allows Tacoma Dome renters the option of turning off the neon sculpture. Most do.

Elsewhere in Washington, the art picture is more embarrassed than angry. The Legislative Building in the capital, Olympia, sports a mural known as "The Twelve Labors of Hercules." Raised in 1981, the work has been covered over since 1982 when state representatives declared it obscene. In April 1987, the legislature voted to remove the work.

But this isn't a painting that can be pulled off a hook and rehung in the back room. This is artwork painted directly onto the wall of the House Chambers. Options are few: "Hercules" may be painted over, peeled off (with major damage to the artwork), or the state may disassemble the wall for relocation. Hobson's choice.

The artist, Michael Spafford, had another

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WIDE WORLD PHOTOS

An exhibit by local arts groups in the Tacoma Dome.

idea. In May 1987, he filed suit to keep the mural in place, regardless of the fact that he had been paid for the work and regardless of public opinion.

Yet "The Twelve Labors of Hercules" had been selected and approved by a peer panel process ahead of painting. Not surprisingly, the art community sympathizes with Spafford.

There's nothing wrong with the principle of public funding for the arts, believes artist and dealer Laura Velaz of Redmond, Washington, as long as the right persons choose artwork appropriate for the intended site. This was managed nicely in fifteenth- and sixteenth-century Europe. "But," she says, "the Medicis had taste."

"Hercules" is the sort of disaster that can't be left up, can't be taken down, and can't be photographed and published in full in the newspapers.

My personal education on public funding for the arts began when my community received county money for a writers' club. I was asked to sit on the board because I had sold a few magazine articles.

Indeed, all of us on the board claimed some personal interest in writing. One said she had done the actual writing for a best-selling book printed with only her husband's byline. Another wrote a play, unpublished. A third did unpaid editing for her church newsletter. One more was married to a doctor who contributed generously to the arts.

Yet the area arts newsletter (a publicly funded freebie) billed the group as "a specialized panel of experts in Literary Arts." Purchases of artworks and arts services nationwide are made by the peer review jury system. But for us, gathering artistic peers was more easily said than done.

How did the writers' board dole out the county "one per cent for the arts" funds, together with club dues? Right away came the post office box. Never mind that for its first four months the box received not one piece of mail. The measure was necessary because "a first-class organization needs its own address," board members said.

Most of the money was spent on newsletters, postage, coffee, and meeting room rents. But when asked by taxpayers where the money went, the first answer was invariably "to pay speakers who are professional writers." In truth, less than a third went to direct encouragement of working writers.

And which writers did the club get for speakers? There were two main types: the ex-writer who began teaching when the muse de-

parted, and the Californian who gave readings from his book on how to found a commune.

Successful writers such as Ernest K. Gann turned us down. "Authors should be read and not seen or heard," he said. And he was right. Writers develop by writing and reading, not by listening to someone else's experiences.

The very premise for this public expense is wrong. In these days of budget deficits, does the public really want to fund dilettantism?

Public dollars should shy from art not because art is frivolous, but because no small group can set the value of art. In that respect the arts are no different from religion or a free press.

No more should public funds pay for someone's art opinion than public funds should pay my pastor's salary or pay this publication for printing my opinion. □

Freedom Footnote

by Paul Rux

"The economist's stock-in-trade—his tools—lies in his ability and proclivity to think about all questions in terms of alternatives. . . . The win-lose, yes-no discussion of politics is not within his purview. He does not recognize the either-or, the all-or-nothing, situation as his own. His is not the world of mutual exclusives. Instead, his is the world of adjustment, of coordinated conflict, of mutual gain."*

There's an old saw about finding great value in small packages. In this case, the textbook footnote cited above opened my eyes to the salient difference between the free market and state intervention in allocating resources.

The footnote is remarkable because it succinctly suggests why the free market is preferable to statism. It emerged as one of the critical insights in a summer of rigorous Ph.D. study of school finance at the University of Wisconsin at Madison. Despite its obscurity, the footnote's bold, bald defense of freedom is worthy of comment.

The footnote reminds us that state action is political. In politics, there's always a "win-lose" situation. For someone to gain, someone else must lose. It's "all-or-nothing," "either-or." Take, for example, an election. There's just one winner. Somebody else must lose and bow to the dictates of the winner. Consequently, whenever the state intervenes, the dynamics of politics are at work; people struggle to avoid ending up empty-handed, bitter, and bossed. For all his faults, Lenin aptly summed up politics as "who/whom." Who's doing what to whom?

Conversely, as the footnote also suggests, in the free market the key is "mutual gain." You give something of value to get something of value. This is a "win-win" situation. Consider, for instance, the purchase of a suit. The customer exchanges money for clothing. The haberdasher gains dollars; the customer gains a new outfit. Both are winners.

In a nutshell, the textbook footnote suggests the superiority of the free market over statism. In the free market, "mutual gain" fosters choice and cooperation, as resources tend to fill the needs of everyone. "Win-lose" statism co-opts these resources and sows division and alienation.

These are our choices. It was quite a surprise to find them spelled out lucidly in a textbook footnote! □

* Walter I. Garms, James W. Guthrie, and Lawrence C. Pierce, *School Finance: The Economics and Politics of Public Education* (Englewood Cliffs, New Jersey: Prentice Hall, 1978), pp. 75-76.

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Some Thoughts on Discrimination

by George C. Leef

"Discrimination" has become a politically and emotionally charged word. To accuse someone of discrimination these days is to accuse him of vile, almost criminal behavior. To say that you advocate legislation to outlaw discrimination and punish those who engage in it will almost surely earn you high praise for your "enlightened," "forward-looking," and "compassionate" point of view. We today devote considerable resources to an endless battle against discrimination. Failure to support this battle with enough enthusiasm will quickly earn you an "anti-civil rights" label.

I maintain that the state of affairs I have described above is foolishness based on some obvious intellectual errors. In the following essay, I hope to make clear exactly why I have reached this conclusion, and what conclusions should be drawn regarding discrimination.

First, I approach this subject from the perspective of a liberal—in the older and correct political meaning of the term. That is, I believe each person has the inherent right to live his life according to his own choices, so long as he does not violate the equal rights of others to do the same. Each of us has a natural right, as John Locke put it, to life, liberty, and property. It is necessarily wrongful for others, therefore, to deprive you of your life, to prevent you from acting as you choose, or to seize or destroy any property you have justly acquired.

This philosophy, I hasten to add, is not a prescription for utopia. Even if everyone consistently adhered to it, there would still be plenty of unhappiness, frustration, and disappointment in the world. Your freedom of action entitles you to do a great many things which do not violate any of my rights (life, liberty, property, or particular rights I may have under contracts) and yet may displease me very much. You can shun my company, refuse my business overtures, criticize my political preferences, or outcompete me, to name just a few. Your actions may be wise or stupid, but you are entitled to take them.

Thus, a world of maximum liberty is not going to be a world of perfect contentment. But it is (or would be) a world affording each person, no matter what his station in life, the best opportunity to live his life happily. Furthermore, it would be a world free of violence and the threat thereof—certainly a most desirable situation.

If you accept my premises regarding human rights, let's see where logic leads us. (Incidentally, I have never met anyone who doesn't claim these rights for himself, who has no complaint about others acting to deprive him of his life, liberty, or property. If you claim these rights for yourself, intellectual consistency seems to dictate that you respect them in others.)

Assume that you want to buy a widget and there are four sellers nearby. You decide to do business with Seller 1. Without any doubt, you have acted within your rights. You have deprived no one of life, liberty, or property when you made your transaction with Seller 1. Sellers 2, 3, and 4 may be unhappy over your

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decision to patronize Seller 1, but you have not violated their rights.

In choosing to do business with Seller 1, and not the others, you have discriminated. That is the very meaning of discrimination—to favor one thing over another. Everyone does so every day. It is an unavoidable consequence of scarcity. And as we have just seen, it does not entail violation of anyone's rights.

Now, does it make any difference *why* you made your choice? Returning to our shopping example, no one would think you had done anything wrong if you had looked at the goods available in the other stores and decided upon Seller 1 because he had a better price or quality. In that case, you had a good reason for making your choice.

But what if you had what many people would regard as a *bad* reason? Assume that Sellers 2, 3, and 4 are all members of a religion different from yours while Seller 1 happens to belong to your church. Or, we can make the example even stronger: you *dislike* the religion of Sellers, 2, 3, and 4, and do business with Seller 1 only because you are indifferent to his religion. This situation corresponds more closely, I believe, to what most people regard as "true" discrimination, a refusal to associate based upon some antipathy. If this is your reason for making your choice, have you violated anyone's rights?

The answer is still no. You have no more deprived Sellers 2, 3, and 4 of anything to which they are entitled than when your decision was based upon a "good" reason. Since others are not *entitled* to your business, your reason for making your choice is irrelevant. You are within your rights to choose—discriminate—upon any criterion whatever. This conclusion follows from the assumption that an individual has a right to act in any way he chooses so long as he does not violate the rights of others.

Finally, consider this possibility. Suppose that you know of the existence of Sellers 2, 3, and 4, but you've heard some unfavorable comments about them, and always buy from Seller 1, whom you know. You haven't even given Sellers 2, 3, and 4 a chance at your business. Have you violated their rights? No, you have not. If you agree that a person is free to use his time as he sees fit, you must say that he may decide not to spend it in searching out information about others. In other words, nothing obligates us to ensure that every one of our decisions is "fair" to everyone who might have been chosen. Making a choice in ignorance about the nature of those discriminated against may be foolish, but it does not violate anyone's rights.

The Right to Choose

At this point, let's note that to say that you have a right to make choices upon any criterion you like does not mean that others have to regard your choice as wise or good. If we go back to the case where you won't buy from Sellers 2, 3, or 4 because you dislike their religion, most people, if they knew that was your reason, would conclude that you were irrational and perhaps even venal for your prejudice. Similarly, in the last case, others might think you a poor shopper for refusing even to consider any seller except the old tried and true. But none of that matters with regard to your right to choose.

If a buyer of goods and services (a consumer) is thus entitled to make any purchasing decision he wants for any reason, is not the same true of a seller? In fact, sellers are buyers too—buyers of labor services, among other things. Let us say that a businessman has a job opening and receives four applications. He can hire only one person. The others will be disappointed. If our previous reasoning was correct, do we not have to conclude that the businessman is entitled to choose among the applicants no matter what his criterion for selection might be? It's his money and property that we're talking about now, but remember that he has the same rights as you do. If the businessman wants to decide on the basis of race, religion, sex, or unverified assumptions, he is just as much within his rights as you were to buy according to your criteria. He may be acting foolishly (some might even argue immorally), but he does not violate the rights of those not chosen. Because the property is his, the right of choice is his.

What I think we have to conclude, then, is that discrimination in buying or selling or hiring or admitting or associating or any other

peaceful endeavor should not be subject to legal restrictions. Since, as we have seen, making such choices is within a person's rights, to force him by law to deal with people he would prefer not to deal with is to violate his rights.

We, of course, have such laws in the United States. Institutions (business firms mostly) which are found by a governmental agency to be guilty of discrimination can be required to begin an "affirmative action plan" whereby they agree to increase their employment of people from "underutilized" groups to a level acceptable to the government.

Such legislation is an assault upon freedom. It is one more step along the road to an engineered society—a society in which people may do as they please only as long as the results of their actions don't upset the government's plans. This I find to be a frightening prospect. It should even frighten the advocates of such governmental power. How can they be certain that the power to control, which they like so much when it is in their hands, will always be in their hands?

Furthermore, "anti-discrimination" laws, while meant to rectify injustices, can in fact be a source of injustice. To illustrate, suppose that a business owner interviews but decides not to hire a person who is in one of the "protected classes" under anti-discrimination law. Assume that the applicant who was hired had superior qualifications. But this is no guarantee that the disgruntled applicant who was not hired won't begin legal action against the owner *alleging* that he or she was discriminated against—rejected solely because of race or sex for instance. The legal proceedings will be costly to the business owner even if he is vindicated, and it is entirely possible that he could lose the case. Discrimination cases, after all, depend on establishing the frame of mind of the decision-maker, and it is quite conceivable that the owner may be unable to successfully rebut the allegation of "discrimination." All of this, I submit, is an injustice to the owner.

Also, the government's favorite remedy for "discrimination," namely "affirmative action," can be unjust to future applicants. To fulfill his mandated quota of employees from a certain category, the employer may have to turn down a qualified applicant who fits into another category.

A very poor but hard-working Vietnamese refugee, for example, might have to be rejected because the employer needs to hire a member of some other ethnic group to avoid legal trouble with the government. The person hired may be less in need of this job and less industrious than the Vietnamese who was passed by, but individual merits are necessarily overlooked when the government insists on treating people as group members rather than as individuals. Whether the nation is any more just as a result of anti-discrimination laws is highly debatable. What is not debatable, however, is that the enforcement of such laws violates the rights of the people against whom they are enforced.

Overcoming Prejudice by Law

What arguments do the advocates of anti-discrimination laws put forward? Their principal contention seems to be that by compelling those who practice discrimination (in the pejorative sense) to associate with the people against whom they are prejudiced, the prejudice will be overcome. And if we agree that the world is a better place without irrational prejudice, haven't we accomplished something good? Isn't it narrow-minded to oppose such laws and the good they do just because it may be a violation of the rights of those compelled to associate against their will?

There are two problems with this argument. First, it assumes that there are beneficial results from forced association. While this is possible, the opposite may be true.

Suppose a seller is required by law to hire people from group Z until at least 10 per cent of his work force is composed of Zs. Perhaps this, in time, will show the seller that his prejudice against Zs was a mistake, and perhaps the non-Zs in the population who are prevented from getting a job with the seller will not be harmed or develop any prejudice against Zs as a result. If that happens, we then have less discrimination.

But the opposite may occur. The Zs whom the seller is forced to hire may prove to be worse employees than the non-Zs, and non-Zs

who now find it more difficult to find jobs may blame their situation on the Zs. Even if you don't think that it is wrong to force someone to associate with others against his will, you should be hesitant to assume that the plusses outweigh the minuses. Governmental policy which officially favors a certain group or groups is apt to impose hardships on all who are not favored. If our goal is to end prejudice and injustice, a policy which itself will produce some of those undesirable things is one we should hesitate to adopt.

The second problem with the statist argument for compelled association is that it assumes that there are no ways to reduce the amount of irrational prejudice in society except by resorting to force. So often, when people identify an imperfection in society, the immediate impulse is to call upon the state to remedy the imperfection. It is easy to understand this impulse. For decades, government has been quick to jump in with "solutions" to all sorts of perceived social ills. Many Americans are now, in effect, government junkies. It doesn't even occur to them that non-governmental efforts to solve a problem are possible and might prove more effective.

For example, if you think a seller discriminates against Zs and you want him to stop, you could approach him and point out his folly, perhaps offering evidence of the success of Zs elsewhere. If that doesn't work, you might offer him a financial incentive to hire one or more Zs (maybe you'd pay for their training). Still no results? You could publicize the seller's refusal to go along with your reasonable proposals and encourage poeple to do business elsewhere. You could even go into competition against the discriminatory seller, employing people, including Zs, strictly on the basis of merit. Successful competitors often teach businesses lessons in an indelible way. And there are probably other things I haven't thought of which could be done without turning to the coercive power of the government.

If it is possible to reduce or eliminate a problem without creating more governmental power, we should do so. To give any government the power to dictate with whom we will associate, and the power to try to change the way people think, is to create the potential for great tyranny. History is rich with examples of power which was originally conferred with the expectation that it would be used for good but later was turned to evil.

A Mere Sideshow?

Finally, I think it worthwhile to ask whether all the furor over "discrimination" isn't beside the point. As I stated earlier, where you stand on anti-discrimination laws is for many people the litmus test of your commitment to civil rights and economic progress for minority groups. But what if such laws are neither necessary nor sufficient to bring about economic progress for the groups they are supposed to help? What if this is merely a noisy and unimportant sideshow, diverting attention from issues which really do matter? I think that is the case.

In the past, one unpopular ethnic group after another made dramatic economic progress in this country, despite the fact that there were no laws against discrimination and no affirmative action plans. And there certainly was much overt discrimination. But there was also nearly unrestricted economic freedom. In the nineteenth and early twentieth centuries the U.S. economy was substantially free of the oppressive burdens of taxation and regulation. Even though some doors were closed to a person due to discrimination, there were always a great many open. Opportunities abounded for each person to acquire skills and use them advantageously in a climate of economic freedom.

Conditions are different today. Due to the degeneration of many of our public schools, particularly in inner-city areas, huge numbers of young people now enter the labor force with extremely poor reading, writing, and mathematics skills. Such people will face discrimination all their lives—discrimination based upon their lack of ability. And due to occupational licensing, minimum wage legislation, and a web of other regulations, it is much harder for many people, especially from a "disadvantaged" background, to find a job and begin a career.

America is far less a land of opportunity than it once was, and it is this sad fact which the people who loudly proclaim their devotion to

civil rights and justice for minority groups should be protesting. Rather than wasting time in trying to artificially engineer equality through state-enforced hiring quotas, I submit that they should join forces with those who advocate a free economy.

As long as our educational system is failing and there are numerous legal obstacles which hinder or prevent people from trying to better themselves in peaceful and productive ways, even the most vigorous enforcement of anti-discrimination laws will not improve the plight of the poor. On the other hand, if we open up our economy so that all can have a chance at advancement, there soon wouldn't be even an appearance of a need for anti-discrimination laws.

To discriminate is simply to choose one thing over another. Unavoidably, we all discriminate every day, choosing with whom we will associate and with whom we will do business. Some of our choices are wise, and some are foolish, although we may not think so at the time. Some decisions are fair to others, and some appear to be quite unfair. But in all instances, the individual has the right to make the choice. With whom we choose to do business or choose to associate with socially are decisions which are entirely within our rights to make. No matter how we make such decisions or what our reasons are for making them, we do not violate the rights of any other person when we do so.

Laws against discrimination are inconsistent with the concept of a free society where the role of the government is to protect each citizen's rights to life, liberty, and property. It is no part of the protection of one person's civil rights to interfere with another person's freedom of choice. Anti-discrimination laws not only violate the natural rights of those against whom they are enforced, they also create injustices. Instead of further expanding the power of government over the individual as these laws do, we should instead reform our present laws to eliminate barriers to opportunity. The solution to our problems is more freedom, not less. □

IDEAS ON LIBERTY

Discrimination

If man is to continue his self-improvement, he must be free to exercise the powers of choice with which he has been endowed. When discrimination is not allowed according to one's wisdom and conscience, both discrimination and conscience will atrophy in the same manner as an unused muscle. Since man was given these faculties, it necessarily follows that he should use them and be personally responsible for the consequences of his choices. He must be free to either enjoy or endure the consequences of each decision, because the lesson it teaches is the sole purpose of experience—the best of all teachers.

When one's fellow men interpose force and compulsions between him and the Source of his being—whether by the device of government or otherwise—it amounts to interrupting his self-improvement, in conflict with what seems to be the Divine design. Man must be left free to discriminate and to exercise his freedom of choice. This freedom is a virtue and not a vice. And freedom of choice sows the seeds of peace rather than of conflict.

—F. A. HARPER

The Job Abacus: No Guide to Public Policy

by James E. McClure and T. Norman Van Cott

Media economic "experts" typically gauge economic events by counting jobs. Regardless of the issue, they measure the desirability of policies and outcomes in terms of the jobs that are allegedly created or destroyed. To the "experts," a never-ending shortage of job opportunities is the fundamental economic problem against which public policies must be arrayed.

Over the last few years, this mind-set has been especially visible in media discussions of government policy toward international trade and plant closings/relocations. With respect to international trade, it is common to observe comparisons of jobs embodied in exports and jobs "lost" because imports are not produced domestically. International trade is judged good or bad depending on whether export-related jobs exceed or fall short of import-related jobs. The reasoning with respect to plant closings/relocations is similar—the change is beneficial only if employment is greater at the new production facilities than at the old facilities.

Regardless of what the experts' abacuses tell us, however, we contend that their answers are irrelevant for measuring economic success.

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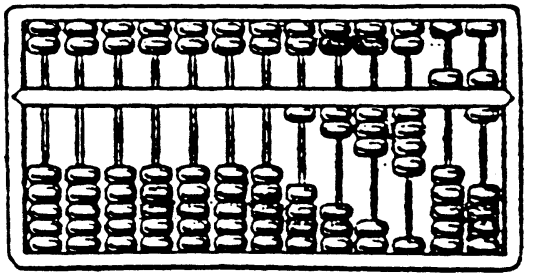

They contradict the fundamental proposition upon which all economic analysis is based—resource scarcity.

Out of Eden

Ever since the debacle in the Garden of Eden, mankind has had a seemingly unquenchable thirst for goods and services. Mankind simply cannot command sufficient labor, capital, and raw materials to produce enough goods and services to satisfy this thirst. Consequently, men have had to choose those goods and services that they value most. Such choices necessarily require the choosers to give up things that are also valuable to them, albeit less valuable than the options they select. In this way, people always fall short of the satiation achieved in the Garden. As long as lower

valued options are sacrificed in favor of more highly valued ones, however, people are doing the best they can given their limited circumstances.

Humans out of Eden are thus cursed with unlimited desires in a fallen world of limited resources. The term that economists use to describe this circumstance is scarcity, and it is this scarcity that undermines the efforts of the job counters.

Scarce Resources Mean Overabundant Jobs

Man's inability to satisfy all his desires implies, by definition, that there are employment opportunities which continually go begging. These opportunities are not seized because they are among the lower valued uses of peoples' limited resources. Potential producers cannot and will not produce when consumers aren't willing to make it worth their while. It always should be remembered that jobs are performed for the mutual benefit of producers and consumers. Without this mutuality, jobs are not filled in a free society. Indeed, the fact that jobs are not filled when this mutuality is absent means that the community is better off overall.

Although an unquenchable thirst for goods and services relative to productive capabilities precludes a scarcity of jobs in general, one can correctly argue that there is a shortage of "good" jobs. Overcoming a scarcity of "good" jobs, however, is not susceptible to the quick-fix nostrums of the alleged media experts. Quite the contrary, sustained success in dealing with this latter scarcity is possible only with increases in an economy's productive capabilities. U.S. economic history validates this latter point to even the most casual observer.

Then Why Is There Unemployment?

How can one reconcile the idea of job overabundance with the observation that unemployment is and has been an economic fact of life? Economists have long noted that dynamic, growing economies always have unemployed resources. This dynamism inevitably means that the locations of some job opportunities are always changing. Those losing jobs as a consequence of these changes are not fully aware of where new opportunities are emerging, nor are employers with the newly available jobs fully aware of potential employees. It is beneficial for all concerned to devote time to "job search"—a euphemism for what is popularly known as unemployment. Search enables employees to find better jobs while simultaneously enabling employers to find better employees. Although stop-start government monetary and fiscal policies disrupt the ease with which this matching occurs, better employer-employee matches lead to higher living standards.

While unemployment due to job searching, properly seen, increases wealth, other forms of unemployment destroy wealth. The latter emanate from the coercive power of the state. For example, government-sanctioned monopolies in labor and product markets prevent some people from producing higher valued goods and services. The excluded resources are forced into either unemployment or lower-valued alternatives. Likewise, minimum wage laws prevent the unskilled from selling their services at a price that is attractive to consumers.

Economic Success and the Job Abacus

Having an actual, honest-to-goodness number upon which to judge economic phenomena is a security blanket for media experts and laymen alike. It not only eliminates the need for rigorous thinking, it also enables one to exude a sense of precision about the matters at issue.

Unfortunately, the job abacus diverts attention from the first principles of economics. Instead, attention becomes riveted on a number that, though it is meaningless in an economic sense, is potentially dangerous to our economic health. Changes in technology, managerial techniques, and consumer desires come to be seen as enemies.

History is replete with examples showing that the economic race is always won by those societies most open to these changes. If we wish to promote economic success, it is better to remember the lessons of economic history and forget the job abacus. □

Government Regulation of Air Safety May Be Hazardous to Your Health

by John Semmens

One would guess from media accounts that it is a proven fact that the skies are less safe due to the 1978 airline deregulation. Whether it be stories of actual crashes or near-collisions, hardly any coverage ends without implying that deregulation is at fault.

It is not that the implication of blame is totally implausible. As advocates of deregulation predicted, air travel is less expensive and more frequent than would have been the case had airlines not been deregulated. In 1987, U.S. airlines flew a record number of flights and passengers—more than a 50 per cent increase over pre-deregulation figures. Obviously, then, the skies are more crowded. And, of course, more crowded must mean more dangerous. Right?

Well, the indictment of deregulation is wrong on two major counts. First, the statistical data show that contrary to what one might surmise, the rate of accidents and fatalities is *lower* in the post-deregulation period. Second, the hair-raising reports of near-collisions at busy airports reveal that there may be serious problems with air traffic control and the allocation of takeoff and landing rights. However, both air traffic control and airport operating practices are public sector activities that have *not* been deregulated.

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The Federal Trade Commission has compared the 1979–1987 post-deregulation record with the 1970–1978 pre-deregulation period. The figures reveal that the accident and fatality rates have declined for all categories of commercial aviation since deregulation. The table on the opposite page provides a summary.

The evidence very clearly shows an improvement in commercial air safety in the U.S. Not only is the accident rate lower, but the number of fatalities is lower despite an increase of over 100 million passengers between 1978 and 1987.

Perhaps the reason these real gains in air safety are not being heralded is the unwillingness of those with an interventionist agenda to accept the implications. From the standpoint of satisfying consumer demand, deregulation is an unqualified success. If interventionists had to concede that flying is also safer, they would have little leverage for undermining the market solution to transportation needs.

So, instead of being encouraged by verifiable gains in safety as represented by decreases in crash rates and fatalities, the public is being bombarded with hysteria bolstered by less precise measures of safety. Two favorite indicators of the allegedly rising danger are the increasing reports of near-collisions and the rise in Federal Aviation Administration (FAA) citations for violations of safety regulations.

The rising reports of near-collisions, how-

Commercial Aviation Accidents

Category	1970-1978	1979-1987	% Change
Major Airlines			
Accident rate*	.580	.266	−54
Fatal Accident Rate	.088	.037	−58
Charter Airlines			
Accident rate*	2.010	1.220	−39
Fatal Accident Rate	.354	.296	−16
Air Taxis & Commuters			
Accident rate*	4.830	3.300	−32
Fatal Accident Rate	1.080	.780	−28
All Commercial Aviation			
Accident rate*	2.340	1.570	−33
Fatal Accident Rate	.496	.355	−28

* The accident rate is accidents per 100,000 flight hours.

ever, might be the result of a more determined effort to look for them. Raising the number of citations could be viewed as a way of creating an apparent need for more FAA funding and authority. Or it could be seen as an increased safety enforcement program made possible by the elimination of the distractions involved in regulating fares and routes. Thus, an increased ability to concentrate on safety enforcement would stand as a desirable by-product of deregulation.

Safety Not Deregulated

Few media stories on air safety make it clear that safety was not deregulated. The FAA retains its extensive responsibilities for aviation safety standards. The FAA is also the operator of the air traffic control system. It is this control system that is supposed to keep planes from running into each other. Further, it needs to be pointed out that all of the overcrowded airports at which the near-collisions are occurring are publicly owned facilities.

The FAA and the public sector owner-operators of airports have neglected to employ the most obvious means of coping with dangerous overcrowding. Failure to charge compensatory fees for scarce landing and takeoff slots has resulted not only in misallocation and inefficient use of resources, but reckless endangerment of the flying public.

Time-of-day pricing is clearly needed at busy airports. Yet, publicly owned facilities routinely base landing fees on weight alone. No adjustments are made for whether the landing takes place during hours of peak demand. Lack of differential pricing leaves no way of measuring the relative value of the scarce landing and takeoff slots.

Because of this system, small, non-radar-controlled planes are attracted into the crowded airspace near busy airports. A demand-based pricing scheme would divert all but the most urgent uses of this crowded airspace to less congested reliever airports. Instead, public officials resort to arbitrary landing slot allocation schemes and much hand-wringing over the threat posed by the small, non-radar-controlled planes.

It is not as if the concept of metering demand via peak/off-peak pricing differentials is unknown to public aviation officials. The airlines themselves are masters of the techniques of using price differentials to obtain higher fares from time-sensitive travelers, while using bargain prices to lure more discretionary travelers to fill what otherwise would be underutilized excess capacity during off-peak periods. The operators of airports and the air traffic control network could manage demand in the same way. Their failure to do so not only wastes time and money, but may be subjecting fliers to unnecessary risks.

Why is it that airlines use this simple marketing strategy, and public authorities do not? Airlines, as privately owned, profit-seeking enterprises, have a strong incentive to pursue efficiency. Airports and the air traffic control system are run by public entities that have little incentive to be efficient. An airline that fails to manage demand and capacity efficiently faces economic losses. An airport that fails to manage demand efficiently is apt to use the peak-period shortage of capacity to demonstrate the "need" for a larger budget and greater subsidies.

Even when it is conceded that the profit motive spurs efficiency, it is frequently asserted that it is insufficient to promote safety. Just why this assertion should be accepted is never very clearly demonstrated. Often, the only evidence offered is a slogan like "people before profits." Overlooked is the reality that catering to the wants of people (including the desire for safety) is the marketplace's only path toward profitability.

Crashes cost money and disrupt business. For example, the stockholders of McDonnell Douglas lost an estimated $200 million in market value of their shares following the crash of a DC-10 in 1979. A perceived safety hazard costs profit-seeking firms money. What does it cost the FAA or public sector airport operators?

The risks to travelers being generated by public sector mismanagement serve as the basis for expanding government budgets and authority. The near-collision dangers created by public sector failure to adopt rational pricing are the very arguments advanced for granting the FAA more power and resources. The dangers fostered by mismanagement of airport capacity are the key argument for higher appropriations to build more runways or additional airports. Could anyone conceive of a more perverse system for running an air transportation network?

The alarms being sounded over air safety are pointing to precisely the wrong answer. It is not that deregulation of fares and routes has gone too far. Rather, the proper message would appear to be that deregulation has not gone far enough. Deregulation of fares and service has been a success because it cleared the way for the profit motive to perform its function of stimulating improvements in air service. If safety lags in any way, it is because the profit motive of the main actors (the FAA and municipal airport authorities) is largely nonexistent.

Without a strong profit motive to guide the management of airspace and airport capacity, we will have no recourse but to continue to rely on the good intentions of public officials. But are the intentions of politicians and bureaucrats so reliable that we should choose them over the proven potency of the profit motive in a competitive market? Perhaps trusting to such good intentions is an act of blind faith that is too risky to justify. □

A REVIEWER'S NOTEBOOK

Wedemeyer on War and Peace

by John Chamberlain

When General George Marshall, a good judge of character, was looking around in the summer of 1941 for a Victory Plan in case we got into war with the Axis powers, he asked Albert C. Wedemeyer, then a major with experience as an exchange student at the German War College in 1936-38, to draft one for him. It was a shrewd move on Marshall's part.

Wedemeyer himself has told the story of his life in his autobiographical *Wedemeyer Reports*. Now we have a selection made by Keith E. Eiler from papers that have been placed on deposit at the Hoover Institution in Stanford, California, published as *Wedemeyer on War and Peace* ($25.95 cloth, $18.95 paper). Some of the papers, if published in the late 1940s, might have altered history in China, but, as Madame Chiang Kai-shek has said, they now come 40 years too late. Wedemeyer, who had been our Far East commander in the provisional Chinese capital of Chungking in 1944 and 1945, warned President Harry Truman that if we did not support Chiang Kai-shek with arms, the Mao Tse-tung Communists would take over. Using weapons seized from the Japanese, Mao did take over, forcing Chiang and the Kuomintang Chinese government to seek refuge on Taiwan, which continues as a free enterprise bastion in Asia.

Wedemeyer's concern was to preserve as much of the world as he could for free enterprise capitalism and democracy. He was all for settling international affairs by peaceful negotiation, and was dubious about the ultimate uses of fighting unless war aims were clearly defined. The fact that Wedemeyer had been a Nebraska isolationist for some years after World War I, a war which had failed to make the world safe for democracy, did not bother Marshall. He had been competently briefed by Wedemeyer on the work of the German War College and he knew that Wedemeyer would put isolationist feelings to one side if he were asked to assume responsibility for a Victory Plan.

Pearl Harbor put Wedemeyer into the war as "Marshall's planner" in a truly active capacity. The Victory Plan, as originally conceived, called for defeating Hitler on the North European plain that was easily accessible from Britain if landing craft were available in sufficient quantity. Wedemeyer set a 1943 date for the invasion of continental Europe. He argued that the best time to go ashore in northern France or the Low Countries was when Hitler's armies were locked with the Russians at Stalingrad and the lower Volga River.

Marshall agreed with Wedemeyer's thinking. They were both partisans of what Wedemeyer called the main thrust. It had worked in World War I. For a time Franklin Roosevelt went along with the main thrust idea. But Wedemeyer shortly discovered that Winston Churchill, who thought first of all in terms of protecting the sea routes of the British Empire, had other ideas.

Churchill doubted that landing craft could be readied in time for a cross-English Channel invasion in 1943. We will never know whether he was right about this. But Churchill succeeded in converting Roosevelt to accepting

1944 as the earliest practical date for invading Europe from the north. To keep allied troops "blooded," Churchill proposed the North African campaign. He remembered that the British of William Pitt's day had let Napoleon waste French energies at the two extremes of Russia and Spain. A North African campaign in 1943 would extend Hitler as Napoleon had been extended.

Wedemeyer on North Africa

The North African campaign contemplated seizing not only Algeria and Tunis, but also Sicily. Then there could be a thrust at Europe's "soft underbelly" up the Italian peninsula. Wedemeyer thought of this as "periphery pecking." He had made studies of port facilities in Dalmatia and southern France and knew that it would be a logistical nightmare to get armies past the Alps by any southern route.

So North Africa was for the most part a waste of time. But it did give General Patton scope for imaginative tank warfare, which paid off in 1945 when the Patton tank thrust reached Czechoslovakia only to be called back for political reasons that had been established at Yalta.

Given a year's time to recover from his defeat at Stalingrad, Hitler had enough forces ready in the west to slow up the Eisenhower-Montgomery push to the Elbe River. What happened was just as Wedemeyer had feared: Soviet troops had taken over in Poland, East Germany, Czechoslovakia, and Hungary before we could get there. Stalin, who was just as much of a dictator as Adolf Hitler, had won his war for eastern Europe.

This, to Wedemeyer, was the result of lack of foresight on the part of all Roosevelt's and Churchill's advisers. Harry Hopkins was a main culprit. Having lost his bet on 1943, Wedemeyer was no longer of much use to Marshall insofar as Europe was concerned. He found himself relegated to China as Vinegar Joe Stilwell's replacement. The "main thrust" in Asia seemed to call for defeating Japan and moving into Manchuria before the Russians could arm Mao Tse-tung. But even as it had happened in Europe, Wedemeyer's main thrust thinking was forestalled in Asia.

In a personal letter, Wedemeyer tells me that his papers "have been available in government archives and at the Hoover Institution for Chinese and American historians for many years, certainly in time for appropriate action to shape a policy against the spread of Communism in the Far East." But Truman let Wedemeyer's reports on the Far East go without any anti-Communist action. It is only now that the mainland Chinese, tired of the inability of Mao's policies to feed them, are turning to capitalist practices.

Wedemeyer has been justified by history, but only after the waste of lives, time, and treasure. He is now proposing the creation of a National Strategy Council to do something better than ad hoc thinking about foreign policy. His proposed council would have advisory functions only. Its members would be appointed by the President. Like Supreme Court justices, they would be provided with small professional staffs.

There are certainly enough good long-term thinkers now working for various think tanks to provide staff for a National Strategy Council. But obviously little will be done to get Wedemeyer's idea moving in an election year. There is little use talking about presidential appointments to a National Strategy Council until we know who the next President will be. □

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Op-Ed Update

FEE's op-ed program, in which we send *Freeman* articles to newspapers around the country, is entering its third year. In our first two years, we placed articles in more than 75 different newspapers, including *The Wall Street Journal, Chicago Tribune, Newsday, Detroit News, Chicago Sun-Times, Houston Chronicle, Cleveland Plain Dealer, Miami Herald, San Diego Union, Orange County Register, San Jose Mercury News, Indianapolis Star, Dayton Daily News, Charlotte Observer, Richmond Times-Dispatch, Allentown Morning Call, Colorado Springs Gazette, Canton Free Press, Washington Times,* and *The Phoenix Gazette.* We received more than 240 tearsheets representing a combined circulation of over 27 million.

We now are expanding this program to include Spanish translations of *Freeman* articles, which are being sent to Hispanic newspapers in the United States as well as to major newspapers in Latin America.

If you see one of our articles in your local paper, we would greatly appreciate it if you would send us a clipping.

—BJS

Economic Crime

It's a mad world, as Paul S. Columbus can attest. The California entrepreneur was just sentenced to two years in prison and fined $100,000 for trying to bring cheap Japanese-made computer chips into the U.S. It seems Mr. Columbus's effort violated the U.S.-Japan price-fixing accord that makes it illegal for Americans to buy chips at free-market (that is, lower) prices. We aren't surprised that a cartel should force U.S. consumers to look to the black market for chips, but it's still quite something to see the day arrive when the U.S. would start throwing people in prison for trying to serve those consumers.

—*The Wall Street Journal,* January 14, 1988

Silkworms or Textiles?

From the perspective of fundamental economic principles, one can often perceive connections between policies that might otherwise be overlooked.

Not long ago, for example, two articles regarding our relationships with China appeared virtually side-by-side in *The Wall Street Journal* (December 21, 1987, page 9). Although apparently devoted to separate topics, they are actually intimately interrelated.

First, the *Journal* reported new limits on China's textile exports to the United States. Under pressure from U.S. officials, the Chinese agreed to an annual growth rate of 3 per cent. This new rate does exceed the 1 per cent growth limit on textile imports from Hong Kong, Japan, South Korea, and Taiwan, but it falls dramatically below China's recent textile export growth rate of 19 per cent.

Just below this article, another piece provided more sinister news. U.S. satellite intelligence reports suggested that China might be shipping more sophisticated Silkworm missiles to Iran.

Of course, these two articles, thus juxtaposed, could provoke outrage. After all, here we are buying Chinese textiles, and what do they do? Arm our adversaries! Perhaps we should conclude that our 3 per cent limit on the growth of textile imports from China is too generous rather than too stingy!

But think again. Remember the basic economic dilemma taught during the first week of any introductory economics class: limited resources force us to choose between guns and butter. In the present context, this principle suggests that, if we would buy more textiles from the Chinese, they would have fewer resources available to devote to Silkworm production.

Furthermore, if we buy more Chinese goods such as textiles, the Chinese will earn more desperately needed foreign exchange which they can use to buy products from our export industries. New job opportunities would emerge to replace those lost for textile workers. Living standards would improve in China and

THE FREEMAN
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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Bruce M. Evans, chairman; Thomas C. Stevens, vice-chairman; Joseph E. Coberly, Jr., vice-president; Don L. Foote, secretary; Lovett C. Peters, treasurer.

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Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

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in the U.S. as both countries concentrated on producing those items for which they have comparative advantages. These are the gains from free trade.

Here then is another example of the unintended but adverse effects of political meddling in the marketplace. If we really want the Chinese to produce fewer guns, shouldn't we butter up to them by buying more—not less—of their textiles?

—RUSSELL SHANNON
Clemson University

The Police Power

The only thing that distinguishes the institution of government from any and every other institution is its possession of police power. It alone has the legal right to incarcerate a person or even take a person's life. Therefore, the more we delegate to our government responsibility for different aspects of our individual and social lives and thereby expand the incidence of police power, the more we move toward a compulsory, authoritarian society and away from a free society. To be truly free we must limit government, i.e., police power, to the administration of justice, and thus provide that social order which is essential to free intercourse.

—MILLER UPTON

(Dr. Upton is former president of Beloit College in Wisconsin.)

The Communist Collapse

As governments in the East bloc have more and more difficulty supplying medical care, housing, and other social services, birth rates in all six countries are declining, despite generous new incentives for larger families. Life expectancy has dropped in some of the six countries—for example, in Hungary, from an average 67 to under 65—and families are feeling the pressure resulting from parents who hold two and sometimes three jobs apiece.

In these countries, where food, health, edu-

cation, public transportation and housing are heavily or totally subsidized, the squeeze on ordinary citizens is amplified by increases in the costs of some consumer goods and rents and, in the case of Hungary, a new income tax. In some East European hospitals, patients are now being asked to supply their own medicines.

Nowhere is the sense of deterioration more evident than in air and water pollution. For example, an official Slovak study concluded recently that Bratislava is the most severely polluted city in all of Europe. Instead of allowing the analysis to be made public, the Government pulped 2,000 copies and sought to sequester those remaining in circulation.

A Czech water quality specialist confided to a visitor that Prague's drinking water contained such a high level of toxins that infants in the capital were restricted to drinking bottled mineral water. To the north in the factory town of Usti nad Labem, air pollution has reached levels that compelled local school authorities to send pupils out of town to special education facilities for four months a year.

—DAVID BINDER,
writing in *The New York Times,*
January 6, 1988

Property and Propriety

Property is related to propriety, and is an ethical institution. It is a feature of our civilization.

The kinship of property with what is proper has been recognized from early times. It has been acknowledged by the people themselves in that genuine expression of popular feeling—language. It has been seen by our great thinkers. No matter what period or aspect of our civilization we may consider, we find that the institution of private property has been defended on grounds of justice, freedom, progress, peace and happiness. Often attacked and suppressed, ultimately free property emerged victorious.

—GOTTFRIED DIETZE,
In Defense of Property

The Will to Power

The chief danger to property has not been from the covetous neighbor nor from the habitual thief. It has been from the acquisitive and confiscatory activities of rulers. The Will to power, the temptation to exercise power simply because one has it, has led rulers to arbitrary interferences with liberty of the person. Covetousness has led them to arbitrary seizure of property. Both have joined to bring about arbitrary interferences with the liberty of using property. It is significant that the current of thought which is giving up the idea of property is also giving up the idea of liberty. As the two grew up together they are a common subject of attack by those who conceive the one must go with the fall of the other.

—ROSCOE POUND,
"The Law of Property
and Recent Juristic Thought,"
American Bar Association Journal (1939)

Available from FEE . . .

We have a limited number of copies of Burt Folsom's *Entrepreneurs vs. The State,* priced at $14.00. (See John Chamberlain's review on page 206.) Call or write FEE to reserve a copy.

THE FREEMAN
IDEAS ON LIBERTY

Undertaxed or Overspent?

by E. C. Pasour, Jr.

Americans and many other members of the world economic community are worried about the U.S. government's budget deficits. The deficit in any year is the amount by which Federal expenditures exceed receipts. Recent turmoil in U.S. and other financial markets has been attributed to uncertainties about whether and how U.S. budget deficits will be reduced.[1]

There is widespread agreement that the deficit should be reduced but little agreement about how to do it. Much of the disagreement has been over whether the Federal deficit should be reduced by increasing taxes or by reducing spending. The factual question of whether budget deficits during the Reagan era have risen because of lower taxes or increased expenditures is important in the public policy debate.

Historical spending and revenue data cannot be used to justify current levels of expenditures or taxation. However, it is important that thoughtful citizens as well as those directly involved in deficit-cutting legislation be informed about the origins of the deficits. Have recent deficits been the result of taxes falling more than spending or of spending increasing more rapidly than taxes?

Public support for tax increases appears to be rooted in the widely held belief that the former explanation is correct. That is, rising budget deficits during the 1980s are considered to be the fruits of one aspect of "Reaganomics"—reductions in tax rates. The following analysis, contrary to the conventional wisdom and typical news story, demonstrates that Federal budget deficits have increased since 1980 because of increases in government expenditures—not because of reductions in tax revenues.

Dr. Pasour is a professor of economics at North Carolina State University at Raleigh.

Federal Expenditures and Receipts Since 1960

A historical perspective is helpful in studying the relationship between Federal taxes, expenditures, and budget deficits. The budget of the federal government was essentially balanced in 1960. Except for one year (1969), there has been a Federal budget deficit each year during the past quarter century. Indeed, budget deficits during the Reagan Administration have been considerably higher than during any other presidency since 1960. The annual budget deficit as a per cent of Gross National Product (GNP) averaged 4.8 per cent during the first 6 years of the Reagan Administration. In contrast, the deficit reached 4 per cent in only one year (1976) from 1960 to 1981.

Tax receipts as a percentage of GNP averaged 18.2 per cent during the 1960s, 18.3 per cent during the 1970s, and 18.8 per cent since 1980.[2] Thus, despite tax law changes, including significant reductions in tax rates in 1981, Federal tax receipts have increased, and have increased as a share of GNP as well, during the Reagan era. Rising tax receipts mean that increased deficits during this period were rooted in government spending policies.

There was a gradual and sustained increase

in Federal expenditures during the 1960s and 1970s. Federal outlays as a per cent of GNP averaged 19.0 per cent during the 1960s and 20.7 per cent during the 1970s. Since 1980, however, Federal expenditures have increased dramatically—averaging 23.6 per cent of GNP.[3] Budget deficits have increased since 1980 because Federal spending has been outstripping tax receipts even though tax receipts are higher, absolutely and as a share of GNP, than they averaged from 1960 to 1980.

Interest Payments and Social Security Expenditures

Some analysts contend that rising budget deficits since 1980 are a result of too little taxation rather than of too much spending. A 1987 study by Citizens for Tax Justice, for example, claims that spending on Federal programs (excluding Social Security and interest payments on the national debt) has declined since 1980 as a share of GNP. In support of this argument, it is shown that total spending excluding interest expense and Social Security declined from 14.9 per cent in 1980 to 14.3 per cent in 1987.[4]

Citizens for Tax Justice attributes increased budget deficits of the 1980s to tax cuts for corporations and high income individuals that began in the late 1970s and accelerated in the early years of the Reagan presidency.[5] The prescription of the Citizens for Tax Justice group is higher taxes on corporations and wealthy individuals, instead of reduced spending for social programs to reduce the budget deficit.

The Citizens for Tax Justice analysis of Federal spending has two major shortcomings. First, even omitting interest expense and Social Security payments from Federal spending data, Federal spending as a share of GNP may not have decreased during the 1980s. For example, total spending as a proportion of GNP averaged 14.5 per cent from 1970 to 1980. Since 1981, however, it has averaged about 15 per cent. Thus, the contention that outlays on Federal programs adjusted in this way have uniformly decreased during the Reagan years is not correct, although this comparison is quite sensitive to the years selected. During the decade of the 1960s, for example, Federal spending, excluding interest expense and Social Security, was slightly higher (15.2 per cent versus 15.0 per cent), on average, than during the Reagan era.

The Citizens for Tax Justice approach to the analysis of government spending trends, however, ignores a more fundamental problem. Why should interest expense on the national debt and Social Security payments be omitted in analyzing trends in government spending? Net interest costs were three times as high in fiscal 1986 as in 1980—the last year of the Carter Administration. It is true that interest costs are determined by interest rates and the amount of debt and, in this sense, are beyond the control of Congress or the President. In a more fundamental sense, however, past government policies are responsible for the current level of debt, and present government policies influence both future levels of debt and current interest rates. Inflationary monetary and fiscal policies, for example, tend to raise interest outlays for any given level of debt.

Moreover, the distortions of economic activity associated with taxation are similar whether the tax receipts are used for interest payments on the debt or for any other program. Thus, we should include interest on government debt when analyzing trends in government spending.

The situation is similar for Social Security, even if the program is treated as a self-funding entity. From the standpoint of the individual participant, Social Security is a transfer program rather than an insurance program. Payments made to recipients are not actuarially determined by contributions, as they are in a bona fide insurance program. Thus, there is no reason to exclude Social Security taxes and payments in analyzing trends in Federal spending and taxation.

Conclusions and Implications

There is a great deal of concern but no consensus about the economic effects of increasing Federal deficits. The effects of higher deficits on economic activity, including interest rates, international trade, and private investment, are debated within the economics profession, and a summary of these issues is beyond the purview of this paper. However, Nobel Laureate James

Buchanan makes a compelling argument that national debt (like private debt) incurred to finance consumption in some past period is tantamount to a reduction in net wealth. He concludes: "The issue of public debt to finance the great and continuing fiscal spree of the 1960s, 1970s and 1980s has been equivalent, in all relevant respects, to the destruction of capital value."[6]

Regardless of the economic effects of higher budget deficits, an analysis of the record of the past quarter century clearly reveals the *source* of the deficits. When compared with the 1960s and 1970s, Federal taxes as a per cent of GNP have *not* decreased during the 1980s, whereas Federal expenditures as a share of GNP have increased substantially during this period. Thus, the evidence strongly supports the conclusion of a recent Tax Foundation analysis of the increased budget deficits of the Reagan era: "We are not undertaxed but overspent."[7] □

1. Jeffrey H. Birnbaum and Ellen Hume, "Budget Negotiators May Try to Delay Gramm-Rudman Cuts if Accord Is Near," *The Wall Street Journal,* November 18, 1987, p. 3.
2. Office of Management and Budget, *Historical Tables: Budget of the United States Government, Fiscal Year 1988* (Washington D.C.: U.S. Government Printing Office, 1987).
3. *Ibid.*
4. Jeffrey H. Birnbaum and Alan Murray, "Reagan's Assumptions in Budget Cutting Talks Called Dubious by Some Involved in His Decisions," *The Wall Street Journal,* October 29, 1987, p. 68.
5. *Ibid.*
6. James M. Buchanan, "Public Debt and Capital Formation," Ch. 18 in *Liberty, Market and State: Political Economy in the 1980s* (New York: New York University Press, 1986), p. 201.
7. Tax Foundation, "Social Welfare Outlays Dominate Federal Government Expenditures," *Tax Features* 31 (September 1987): pp. 1-4.

IDEAS ON LIBERTY

What Is Seen and What Is Not Seen

Have you ever heard anyone say: "Taxes are the best investment; they are a life-giving dew. See how many families they keep alive, and follow in imagination their indirect effects on industry; they are infinite, as extensive as life itself."

The advantages that government officials enjoy in drawing their salaries are *what is seen.* The benefits that result for their suppliers are also *what is seen.* They are right under your nose.

But the disadvantage that the taxpayers try to free themselves from is *what is not seen,* and the distress that results from it for the merchants who supply them is *something further that is not seen,* although it should stand out plainly enough to be seen intellectually.

When a government official spends on his own behalf one hundred sous more, this implies that a taxpayer spends on his own behalf one hundred sous the less. But the spending of the government official *is seen,* because it is done; while that of the taxpayer *is not seen,* because—alas!—he is prevented from doing it.

—FREDERIC BASTIAT

The Brady Report: Threat to Stock Market Stability

by Christopher L. Culp

The President's Task Force on Market Mechanisms, created in the wake of the October 19 stock market crash, has recommended actions designed to make the stock and derivative markets more stable. But the Commission, headed by Nicholas F. Brady, has made proposals which would actually increase the likelihood that another crash will occur.

Part of the problem with the Brady Commission's recommendations lies in its interpretation of the role that futures markets play in maintaining the financial integrity of the market system. In particular, the Commission neglects the role of the Chicago Mercantile Exchange (CME) as an instrument of risk management for the New York Stock Exchange (NYSE). The most popular of all the futures markets is CME's Standard & Poor's 500 stock index futures market. On this market, contracts are traded anticipating price changes in stocks on the NYSE.

The Brady report maintained that the behavior of the futures market was one cause of the "market break" on October 19, 1987. The report explains that almost one hour into the trading day, portfolio insurers attempting to cover their losses with gains from sales of futures contracts were driving prices down. This, in turn, increased selling pressure on the futures markets. Index arbitrage—a financial strategy whereby an investor can gain profits from price disparities between index futures and their underlying stocks—was one factor in transmitting the selling pressure to the NYSE. The Commission fell into the camp of those who feel that because the market adjusted accordingly to the S & P 500 index of the futures market—almost a self-fulfilling prophecy—the "tail was wagging the dog."

That analysis is not altogether inaccurate. However, the conclusions that the Commission drew from that premise are not ones that would decrease market volatility. Because the Brady Commission saw these markets as fundamentally linked and felt that the downfall of one led, in part, to the downfall of another, it recommended several courses of action to prevent another market dysfunction from causing yet another market break.

Perhaps its greatest error is recommending that margin requirements should be consistent between stock and futures markets. The Commission study implies that futures margins should be changed to decrease speculation in the futures market and to limit the amount of leverage that individual investors have in the futures market. Some critics feel that the overleveraging of the futures market was partially if not totally responsible for the bullish climb of the market from August 1982 to Black Monday.

The Commission is quick to bring up the possibility of cross-margining to illustrate that they are not simply trying to raise futures margins. Cross-margining implies that while some margins may increase, others will de-

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crease, having little net effect on the margins paid by the investor. Even though the Commission may not be trying to raise margins, their conclusions are rooted in a general misunderstanding of the *function* of futures margins. Although few would argue with the Commission's assertion that the futures and stock markets are *one* market, it is a different issue altogether to say that futures margins and stock margins can be examined and regulated as one.

Futures margins serve an entirely different purpose than stock margins. While stock margins represent a percentage of actual ownership in an investment, futures margins are simply price insurance mechanisms contained in stock-derivative futures contracts—"performance bonds," if you will. It would be a serious mistake to allow the government the responsibility of making margins consistent between these two markets. The alternative to government intervention already exists in Chicago, where margins are determined largely by market movements.

Some people argue that CME margins are too low, but they are in many ways much stricter than their NYSE counterparts. If the S & P 500 fluctuates, the investors are responsible for paying the per cent of that fluctuation, often making their margins near NYSE levels. The maintenance margins at CME ensure that investors have adequate capital backing at all times. In contrast to a popular view that stock margins are always higher than futures margins, the NYSE allows a number of exemptions in margin requirements for such things as block trading and arbitrage, often bringing their margins below CME margins.

Furthermore, while the NYSE has a five-day settlement period, the CME has a twenty-four hour settlement period. The CME does not extend credit. On Black Monday, the CME collected $2.6 billion (against an average $100 million) and established its liquidity for the Tuesday open. The CME's Committee of Inquiry explains, "All margin calls were met, no clearing member defaulted, and thus no customer funds were lost due to insufficient financial integrity."[1] Furthermore, the CME had two *intra*-day margin calls that were met by investors within one hour of their issue.[2] The real doubt came from the uncertainty of whether New York investors would still have liquidity five days after the crash. That time lag created doubts that caused a number of problems at the open on Tuesday, October 20.

The Commission did not demonstrate that it understood the necessity of the futures market as a mechanism of risk management. Its recommendation for consistent margins is clearly indicative of this. The Commission apparently failed to understand the significance of "speculation." Often thought of as random gambling, speculation on the futures exchange is actually short-term investment. Speculators provide the market with buyers when prices are low and sellers when prices are high. Without speculators, long-term investment would be next to impossible. Furthermore, by buying or selling against market pressure, they allow long-term investors to "hedge" their risks, thereby strengthening the entire market and preventing order imbalances (cited by the Commission as one of the main reasons that many NYSE stocks could not open on Black Monday).

The Role of Speculators

Speculators are willing to take the risks that hedgers want to avoid, and the effect of this is the strengthening of the market. To establish a strong market, it is essential that buyers and sellers both exist. Unreasonable recommendations by the Commission regarding margins would tend to drive away much of the necessary speculation on the futures market. On October 19, speculators in the CME served a vital function. When the pressure to sell was tremendous, the local speculators were buying futures contracts. In New York, the inability of the market specialists to find buyers for stocks is cited by the task force as another major reason for the fall. Some NYSE specialists emerged as net sellers—not buyers—on Black Monday.

While NYSE's risk management mechanism failed, speculation on the CME worked. It successfully absorbed selling pressure and broke the fall of the NYSE. It is estimated that CME absorbed 27,000 contracts on Black Monday. Had those contracts been transmitted back to the NYSE, they would have represented approximately 85 million shares of stock, or 14

per cent of the total NYSE volume that day.[3]

The task force never fully realized the significance of speculation. Allowing Self-Regulatory Organizations (SRO's) to set margins instead of the government would help keep speculators in the market. This would put the assets of the members of the SRO at risk. The fear of market failure will lead the investors virtually to insist on adequate maintenance margins, but these margins will be flexible to change with market fluctuations. Because investors have a direct stake in the market and government does not, market-based margin requirements will support the system far better than government regulation can.

A drop in the number of speculators that higher futures margins might precipitate would undermine the principal function of the stock index futures exchanges—risk management. Markets such as the S & P 500 were created because there was a great demand for them. If the Commission's recommendations succeed in stifling the risk management process, there will still be a demand for risk management. Since a number of domestic stocks exist on foreign markets, there is nothing to stop investors from hedging their risks overseas. If the U.S. futures market is no longer available for speculation, the market demand will be exported. Needless to say, this would not have the effect of strengthening the U.S. stock market.

The Brady report also mistakenly calls for "circuit breakers" to stop another fall, should it occur. The impracticality of this idea can be seen in the Hong Kong market. Its decision to close did not "calm" the market; it intensified the panic. Hong Kong did not find that its problems had gone away one week later. The U.S. stock markets do not need circuit breakers to shut them down. They need "surge protectors" so that American markets can accommodate the intense stress of a precipitous fall without shutting down completely and intensifying the loss of investor confidence.

A Grave Error

A circuit breaker that the Commission calls for is the imposition of price limits on the markets. This would be a grave error on the Chicago Mercantile Exchange. The very nature of the CME is to allow the investor to set prices. Charles Seeger of the CME states that the futures market is ". . . a forum for price discovery."[4] Futures markets function as a producer of information. Prices are the result—not the cause—of markets. Imposing price limits on the futures market would treat the symptom, not the disease. Imposing price limits on the futures markets would be much like a doctor who tells a patient that he has a temperature, and then tries to cure it by saying, "Hopefully, it will be gone tomorrow."

Furthermore, price limits would simply delay the movement of the market. It is naive to think that price limits would do anything more than forestall the inevitable. Without price limits, the market will proceed to its "destination" with as much speed as possible. Since a purpose of futures markets is to set prices, it is to the advantage of the investor to know the future price as soon as possible. Allowing the market to move with utmost speed to its destination will cause a "panic of the moment," as happened on Black Monday. But it will alleviate the much greater problem of prolonged panic, as happened in Hong Kong—or on a larger scale, the Great Depression. Once prices have been established, investors can deal with trades at face value, rather than trying to second guess the market's movement.

Several people have expressed the view that the October market break was nothing more than market equalization. The market was running above its capacity, and the break was a redefinition of capacity in the marketplace. The general attitude in London after the crash was surprise to see Americans acting as shocked as they had. They felt that markets are supposed to rise and fall—what was so different about this time?

There is an unquestionable need to create a system of surge protectors, but the recommendations of the Brady Commission do not provide the proper solutions. The solutions lie in the private sector—not with the government. A major problem is public confidence in the market. Fear by investors that there is no liquidity in the market is largely due to the inadequate technology present in the existing information-clearing mechanism, particularly with respect to opening prices. Modernizing the ex-

isting system would remove many of the problems associated with investor confidence. The private sector can also more effectively assure adequate capital backing to the market makers and specialists than government regulations can. Indeed, the NYSE might do well to reconsider the entire specialist system.

The U.S. also would profit to look at London as an example. Studies there urge less regulation, more arbitrage, and more investor involvement. U.S. investment firms are cowering away from arbitrage and program trading for little apparent reason. It is this reaction by U.S. investment firms that perpetuates—not alleviates—fear of market safety. And this fear, like a disease, could soon be contracted by Congress.

With any luck, Congress will give short shrift to the Brady Commission recommendations as it continues to hold hearings throughout the year. Creating higher futures margins and circuit breakers will have the effect of increasing—not decreasing—the likelihood that Black Monday will happen all over again. □

1. Merton H. Miller, et al., *Preliminary Report of the Committee of Inquiry Appointed by the Chicago Mercantile Exchange to Examine the Events Surrounding October 19, 1987,* December 22, 1987, p. 48.
2. *Ibid.*, p. 46.
3. *Ibid.*, p. 30.
4. Charles Seeger, Vice President of Governmental Affairs, Chicago Mercantile Exchange, address before The Jefferson Group, February 5, 1988.

Wage Earners and Employers

by Ludwig von Mises

Q. "Are the interests of the American wage earners in conflict with those of their employers, or are the two in agreement?"

A. To answer that question we must first look at a little history. In the pre-capitalistic ages, a nation's social order and economic system were based upon the military superiority of an elite. The victorious conqueror appropriated to himself all the country's utilizable land, retained a part for himself, and distributed the rest among his retinue. Some got more, others less, and the great majority nothing. In the England of the early Plantagenets, a Saxon was right when he thought: "I am poor because there are Normans to whom more was given than is needed for the support of their families." In those days the affluence of the rich was the cause of the poverty of the poor.

Conditions in the capitalistic society are different. In the market economy the only way left to the more gifted individuals to take advantage of their superior abilities is to serve the masses of their fellowmen. Profits go to those who succeed in filling the most urgent of the not-yet-satisfied wants of the consumers in the best possible and cheapest way.

The profits saved, accumulated, and plowed back into the plant benefit the common man twice. First, in his capacity as a wage earner, by raising the marginal productivity of labor

Editors' note: *Ludwig von Mises (1881-1973) was a pre-eminent exponent of free market economics during his long and distinguished academic career. He was associated with The Foundation for Economic Education as a consultant and part-time staff member from shortly after FEE was founded in 1946 until his death in 1973. We wish to thank his widow, Margit von Mises, for permission to publish this transcript of Professor Mises' response to the question: "Are the interests of the American wage earners in conflict with those of their employers, or are the two in agreement?" These remarks were broadcast during the intermission of the U.S. Steel Concert Hour, May 17, 1962.*

and thereby real wage rates for all those eager to find jobs. Then later again, in his capacity as a consumer when the products manufactured with the aid of the additional capital flow into the market and become available at the lowest possible prices.

The characteristic principle of capitalism is that it is mass production to supply the masses. Big business serves the many. Those outfits that are producing for the special tastes of the rich never outgrow medium or even small size. Under such conditions those anxious to get jobs and to earn wages and salaries have a vital interest in the prosperity of the business enterprises. For only the prosperous firm or corporation has the opportunity to invest, that is, to expand and to improve its activities by the employment of ever better and more efficient tools and machines.

The better equipped the plant is, the more the individual worker can produce within a unit of time, and the higher is what the economists call the marginal productivity of his labor and, thereby, the real wages he gets. The fundamental difference between the conditions of an economically underdeveloped country like India and those of the United States is that in India the per head quota of capital invested, and thereby the marginal productivity of labor, and consequently wage rates, are much lower than in this country. The capital of the capitalists benefits not only those who own it, but also those who work in the plants and those who buy and consume the goods produced.

And then there is one very important fact to keep in mind. When, as we did in the preceding observations, one distinguishes between the concerns of the capitalists and those of the people employed in the plants owned by the capitalists, one must not forget that this is a simplification that does not correctly describe the real state of present-day American affairs. For the typical American wage earner is not penniless. He is a saver and investor. He owns savings accounts, United States Savings Bonds and other bonds, and first of all insurance policies. But he is also a stockholder. At the end of the last year [1961] the accumulated personal savings reached $338 billion. A considerable part of this sum is lent to business by the banks, savings banks, and insurance companies. Thus the average American household owns well over $6000 that are invested in American business.

The typical family's stake in the flourishing of the nation's business enterprises consists not only in the fact that these firms and corporations are employing the head of the family. There is a second fact that counts for them, to wit, that the principal and interest of their savings are safe only as far as American free enterprise is in good shape and prospering. It is a myth that there prevails a conflict between the interests of the corporations and firms and those of the people employed by them. In fact, good profits and high real wages go hand in hand. □

Democracy's Road to Tyranny

by Erik von Kuehnelt-Leddihn

Plato, in his *Republic,* tells us that tyranny arises, as a rule, from democracy. Historically, this process has occurred in three quite different ways. Before describing these several patterns of social change, let us state precisely what we mean by "democracy."

Pondering the question of "Who should rule," the democrat gives his answer: "the majority of politically equal citizens, either in person or through their representatives." In other words, equality and majority rule are the two fundamental principles of democracy. A democracy may be either liberal or illiberal.

Genuine liberalism is the answer to an entirely different question: *How* should government be exercised? The answer it provides is: regardless of *who* rules, government must be carried out in such a way that each person enjoys the greatest amount of freedom, compatible with the common good. This means that an absolute monarchy could be liberal (but hardly democratic) and a democracy could be totalitarian, illiberal, and tyrannical, with a majority brutally persecuting minorities. (We are, of course, using the term "liberal" in the globally accepted version and not in the American sense, which since the New Deal has been totally perverted.)

How could a democracy, even an initially liberal one, develop into a totalitarian tyranny? As we said in the beginning, there are three avenues of approach, and in each case the evolution would be of an "organic" nature. The tyranny would evolve from the very character of even a liberal democracy because there is, from the beginning on, a worm in the apple: freedom and equality do not mix, they practically exclude each other. Equality doesn't exist in nature and therefore can be established only by force. He who wants geographic equality has to dynamite mountains and fill up the valleys. To get a hedge of even height one has to apply pruning shears. To achieve equal scholastic levels in a school one would have to pressure certain students into extra hard work while holding back others.

The first road to totalitarian tyranny (though by no means the most frequently used) is the overthrow by force of a liberal democracy through a revolutionary movement, as a rule a party advocating tyranny but unable to win the necessary support in free elections. The stage for such violence is set if the parties represent philosophies so different as to make dialogue and compromise impossible. Clausewitz said that wars are the continuation of diplomacy by other means, and in ideologically divided nations revolutions are truly the continuation of parliamentarism with other means. The result is the absolute rule of one "party" which, having finally achieved complete control, might still call itself a party, referring to its parliamentary past, when it still was merely a *part* of the diet.

A typical case is the Red October of 1917. The Bolshevik wing of the Russian Social Democratic Workers' Party could not win the elections in Alexander Kerenski's democratic Russian Republic and therefore staged a coup with the help of a defeated, marauding army and navy, and in this way established a firm socialistic tyranny. Many liberal democracies are enfeebled by party strife to such an extent that revolutionary organizations can easily

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seize power, and sometimes the citizenry, for a time, seems happy that chaos has come to an end. In Italy the *Marcia su Roma* of the Fascists made them the rulers of the country. Mussolini, a socialist of old, had learned the technique of political conquest from his International Socialist friends and, not surprisingly, Fascist Italy was the second European power, after Laborite Britain (and long before the United States) to recognize the Soviet regime.

The second avenue toward totalitarian tyranny is "free elections." It can happen that a totalitarian party with great popularity gains such momentum and so many votes that it becomes *legally* and democratically a country's master. This happened in Germany in 1932 when no less than 60 per cent of the electorate voted for totalitarian despotism: for every two National Socialists there was one international socialist in the form of a Marxist Communist, and another one in the form of a somewhat less Marxist Social Democrat. Under these circumstances liberal democracy was doomed, since it had no longer a majority in the Reichstag. This development could have been halted only by a military dictatorship (as envisaged by General von Schleicher who was later murdered by the Nazis) or by a restoration of the Hohenzollerns (as planned by Brüning). Yet, within the democratic and constitutional framework, the National Socialists were bound to win.

How did the "Nazis" manage to win in this way? The answer is simple: being a mass movement striving for a parliamentary majority, they singled out unpopular minorities (the smaller, the better) and then rallied popular support against them. The National Socialist Workers' Party was "a popular movement based on exact science" (Hitler's words), militating against the hated few: the Jews, the nobility, the rich, the clergy, the modern artists, the "intellectuals," categories frequently overlapping, and finally against the mentally handicapped and the Gypsies. National Socialism was the "legal revolt" of the common man against the uncommon, of the "people" (*Volk*) against privileged and therefore envied and hated groups. Remember that Lenin, Mussolini, and Hitler called their rule "democratic"—*demokratiya po novomu, democrazia organizzata, deutsche Demokratie*—but they never dared to call it "liberal" in the worldwide (non-American) sense.

Carl Schmitt, in his 93rd year, analyzed this evolution in a famous essay entitled "The Legal World Revolution": this sort of revolution—the German Revolution of 1933—simply comes about through the ballot and can happen in any country where a party pledged to totalitarian rule gains a relative or absolute majority and thus takes over the government "democratically." Plato gave an account of such a procedure which fits, with the fidelity of a Xerox copy, the constitutional transition in Germany: there is the "popular leader" who takes to heart the interest of the "simple people," of the "ordinary, decent fellow" against the crafty rich. He is widely acclaimed by the many and builds up a body guard only to protect himself and, of course, the interests of the "people."

In the Name of the People

Think of Hitler's SA and SS and also of the tendency to apply wherever possible the prefix *Volk* (people): *Volkswagen* (people's car), *Volksempfänger* (people's radio set), *das gesunde Volksempfinden* (the healthy sentiments of the people), *Volksgericht* (people's law court). Needless to say that this verbal policy continues in the "German Democratic Republic" where we see a "People's Police," a "People's Army," while Moscow's satellite states are called "People's Democracies."

All this implies that in earlier times only the elites had a chance to govern and that now, at long last, the common man is the master of his destiny able to enjoy the good things in life! It matters little that the realities are quite different. A very high-ranking Soviet official recently said to a European prince: "Your ancestors exploited the people, claiming that they ruled by the Grace of God, but we are doing much better, we exploit the people in the name of the people."

Then there is the third way in which a democracy changes into a totalitarian tyranny. The first political analyst who foresaw this hitherto-never-experienced kind of evolution was Alexis de Tocqueville. He drew an exact and frightening picture of our Provider State

(wrongly called Welfare State) in the second volume of his *Democracy in America,* published in 1835; he spoke at length about a form of tyranny which he could only describe, but not name, because it had no historic precedent. Admittedly, it took several generations until Tocqueville's vision became a reality.

He envisaged a democratic government in which nearly all human affairs would be regulated by a mild, "compassionate" but determined government under which the citizens would practice their pursuit of happiness as "timid animals," losing all initiative and freedom. The Roman Emperors, he said, could direct their wrath against individuals, but control of all forms of life was out of the question under their rule. We have to add that in Tocqueville's time the technology for such a surveillance and regulation was insufficiently developed. The computer had not been invented and thus his warnings found little echo in the past century.

Tocqueville, a *genuine* liberal and legitimist, had gone to America not only because he was concerned with trends in the United States, but also on account of the electoral victory of Andrew Jackson, the first Democrat in the White House and the man who introduced the highly democratic Spoils System, a genuine invitation to corruption. The Founding Fathers, as Charles Beard has pointed out, hated democracy more than Original Sin. But now a French ideology, only too familiar to Tocqueville, had started to conquer America.

This portentous development lured the French aristocrat to the New World where he wanted to observe the global advance of "democratism," in his opinion and to his dismay bound to penetrate everywhere and to end in either anarchy or the New Tyranny—which he referred to as "democratic despotism." The road to anarchy is more apt to be taken by South Europeans and South Americans (and it usually terminates in military dictatorships in order to prevent total dissolution), whereas the northern nations, while keeping all democratic appearances, tend to founder in totalitarian welfare bureaucracy. The lack of a common political philosophy is more conducive to the development of outright revolutions in the South where civil wars tend to be "the continuation of parliamentarism with other (and more violent) means," while the North is rather given to evolutionary processes, to a creeping increase of slavery and a decrease of personal freedom and initiative. This process can be much more paralyzing than a mere personal dictatorship, military or otherwise, without an ideological and totalitarian character. The Franco and Salazar regimes and certain Latin American authoritarian governments, all mellowing with the years, are good examples.

Slouching Toward Servitude

Tocqueville did not tell us just how the gradual change toward totalitarian servitude can come about. But 150 years ago he could not exactly foresee that the parliamentary scene would produce two main types of parties: the Santa Claus parties, predominantly on the Left, and the Tighten-Your-Belt parties, more or less on the Right. The Santa Claus parties, with presents for the many, normally take from some people to give to others: they operate with largesses, to use the term of John Adams. Socialism, whether national or international, will act in the name of "distributive justice," as well as "social justice" and "progress," and thus gain popularity. You don't, after all, shoot Santa Claus. As a result, these parties *normally* win elections, and politicians who use their slogans are effective vote-getters.

The Tighten-Your-Belt parties, if they unexpectedly gain power, generally act more wisely, but they rarely have the courage to undo the policies of the Santa parties. The voting masses, who frequently favor the Santa parties, would retract their support if the Tighten-Your-Belt parties were to act radically and consistently. Profligates are usually more popular than misers. In fact, the Santa Claus parties are rarely utterly *defeated,* but they sometimes defeat themselves by featuring hopeless candidates or causing political turmoil or economic disaster.

A politicized Saint Nicholas is a grim taskmaster. Gifts cannot be distributed without bureaucratic regulation, registration, and regimentation of the entire country. Countless strings are attached to the gifts received from "above." The State interferes in all domains of human existence—education, health, transpor-

A politicized Santa Claus is a grim taskmaster.

tation, communication, entertainment, food, commerce, industry, farming, building, employment, inheritance, social life, birth, and death.

There are two aspects to this large-scale interference: statism *and* egalitarianism, yet they are intrinsically connected since to regiment society perfectly, you must reduce people to an identical level. Thus, a "classless society" becomes the real aim, and every kind of discrimination must come to an end. But, discrimination is intrinsic to a free life, because freedom of will and choice is a characteristic of man and his personality. If I marry Bess instead of Jean, I obviously discriminate against Jean; if I employ Dr. Nishiyama as a teacher of Japanese instead of Dr. O'Hanrahan, I discriminate against the latter, and so forth. (One should not be surprised if an opera house that rejects a 4-foot tall Bambuti singer for the role of Siegfried in Wagner's "Ring" is accused of racism!)

There is, in fact, only either just or unjust discrimination. Yet, egalitarian democracy remains adamant in its totalitarian policy. The popular pastime of modern democracies of punishing the diligent and thrifty, while rewarding the lazy, improvident, and unthrifty, is cultivated via the State, fulfilling a demo-egalitarian program based on a demo-totalitarian ideology.

Democratic tyranny, evolving on the sly as a slow and subtle corruption leading to total State control, is thus the third and by no means rarest road to the most modern form of slavery. □

Mom's Monopoly, Part II

by Susan J. Osburn

One day, Sam came home from school in an anxious state of mind:

Sam: Mom, I'm in trouble now.

Mom: Why?

Sam: I did so well on my economics essay, with the help you gave me, that now Miss Snick wants me to present a project on the market system.

Mom: Can you do it as a practical project rather than as an essay?

Sam: Yeah, I guess so.

Mom: You can do it along with your fund-raising project for the band. Aren't you going to sell something?

Sam: Yeah! We're going to sell Booster Buttons, you know, badges that say "Hale High" and have the Hale Hyena printed on them, to the kids at school.

Mom: Okay, that can be your example of the market process. The band will be like a firm, offering a supply of a product to the market for purchase and consumption by your pool of potential buyers, the students. How much are you going to charge per badge?

Sam: About 50 cents, I guess.

Mom: Why that price?

Sam: Well, most kids can afford it, and we'll still make money.

Mom: So your decision on the price is based first of all on what you think your buyers will pay. How much does it cost you for each badge?

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Sam: We checked with Wholesale Badges and it was 20 cents.

Mom: What would you have done if the wholesale company had wanted to charge you 75 cents a button?

Sam: We'd have looked for some other thing to sell. You can't sell stuff for over a dollar at school. The kids are too broke.

Mom: Right. Price was your first consideration in deciding how to enter this market. You worked back from your price to determine what costs you could allow. Doing that shows you already had some information about your market. Knowledge and the use of it are important for both the buyer and the seller. The kids at school have to have some idea whether 50 cents is a reasonable price for a Booster Button, or a rip-off; and you as a seller have to know how much your buyers are likely to spend for your type of product. How many kids are in the school?

Sam: Two thousand.

Mom: What makes you think they'll want Booster Buttons? How many will want them? How many will you get from the wholesaler?

Sam: We wish we knew! We have to guess.

Mom: Yes, you do. Any firm has to guess what demand for its products will be, because you have to produce them before they can be bought. Then you correct yourself after you see what happens, and make a more educated guess each time. Suppose you get 1,000 buttons, but only sell 750?

Sam: We'd have a sale. We'd knock the rest down to 30 cents to get rid of them.

Mom: Suppose you did that and sold them all. How much would you make?

Sam: Uh—(pencil and paper)—750 times 50 cents—and 250 times 30 cents—$450! Wow!

Mom: Don't forget those buttons cost you something.

Sam: Oh, yeah. 1,000 times 20 cents—$200. We only make $250. Still okay.

Mom: The reason you had to have a sale is that your supply was too great for the demand at that price. You had a surplus. Even though it may not be so great for the band if that happens, it will be OK for your report, as long as you understand what's happening. The quantity demanded at 50 cents was 750; at 30 cents it was 1,000—or at least you could express it that way and avoid confusion caused by the changes in the market brought about by your previous sale of the buttons at 50 cents.

Sam: What I hope will happen is that our Booster Buttons get to be the fad at school, and everyone will buy one!

Mom: That could happen. Changes in taste are some of the factors that affect demand. Another factor would be income changes; for instance, if all the parents took away their kids' allowances, or all the parents gave their kids raises. More money in your fellow students' pockets would increase the demand, not just the quantity you could sell. If we lived in Beverly Hills you could be selling Booster Buttons for $2 apiece.

Sam: Not with the Hale Hyena on them, we couldn't.

Mom: That goes without saying. Now, suppose the buttons got to be a fad and you sold the whole thousand in two days and kids were begging you for more?

Sam: We'd go to Wholesale Badges and order a lot more!

Mom: Two thousand more?

Sam: No, that might be too many. We'd have to think about it.

Mom: So you kids would be showing the characteristics of an entrepreneur: alertness to opportunities, and judgment in responding to them. You notice that you have a chance to sell more badges, so you arrange to get more, but not so many that you can't sell them and end up losing money. Here's another thing to think about: What if the choir started selling booster buttons also? And the cheerleaders were selling shakeroos at the same time?

Sam: Hmm. We'd be competing with the choir. We might have to lower our price. But shakeroos are different. Kids might like it best if they could have a button *and* a shakeroo. Especially girls.

Mom: Right. Two different Booster Buttons on the market are substitute or rival products. Both you and the choir might have to drop prices. The shakeroos might be complementary products to the Booster Buttons. As more shakeroos are sold, Booster Button sales might go up because kids want a full set of rah-rah products.

Here's something else to think about. What if Mr. Hack, the principal, was worried that maybe some kids couldn't afford 50 cents, so he ordered you to sell your buttons for 25 cents?

Sam: Oh, brother. If we could only make 5 cents a button, it wouldn't be worth it. We might as well just ask for donations and forget about selling Booster Buttons. Or maybe just let a couple hundred be sold through the bookstore.

Mom: So by restricting the price you could charge, Mr. Hack would actually reduce the availability of Booster Buttons to a very low number or maybe to zero. Then not only the poor kids would lack Booster Buttons, the whole school might miss out on them. That tendency for supply to be reduced is an effect of price controls in bigger markets, too. In fact, it's generally true that firms increase the supply of products for which they can get a better price, and decrease supply if the price is less. Price controls are just a special case.

Sam: That's just common sense.

Mom: Yes, a lot of these ideas in economics

are based on the way people actually do things in their best interests. If you try to imagine something happening in the market based on crazy behavior, like people buying Booster Buttons for $100 apiece or the band's only offering five of them for sale, you have a lousy argument.

Sam: We just have to wait and see what happens when we start selling, don't we? We can't predict it exactly or control what happens.

Mom: That's right. The market consists of interaction between buyers and sellers, so things sort themselves out naturally. As prices go up, buyers buy less; if they are lower, larger quantities are demanded. On the other hand, sellers like to sell at a high price, so they supply more at higher prices, less at lower prices. They can only do that to the extent that the buyers will buy, though! So somewhere in the middle is where prices actually end up as a result of that interaction.

As long as nobody like Mr. Hack or the government interferes, the price you end up with is fair and the supply of goods pretty much matches the customers' wants. Economists make graphs about this called supply and demand curves. You can make one for Miss Snick, if you want to, but remember that graphs are only drawings. A supply and demand graph describes market interactions about as well as a stick figure describes a person, yet the graph can be useful for explaining markets to a novice.

Sam: You mean the way a stick figure describes humans to a space alien?

Mom: Yes. Are you all set now?

Sam: Yeah, Mom. Are you going to put up the $200 to buy the buttons from Wholesale Badges?

Mom: *WHAT??* □

Next month, in the third and final installment of "Mom's Monopoly," Sam and his mother discuss competition and antitrust.

Caveat Emptor

by Walter Block

In Peterborough, Ontario, 21-year-old Christopher Green died after being crushed by an 800-pound Coca-Cola dispenser. The young man was trying to steal a Coke by tipping the machine toward him, and had asked his friends to push from behind.

However, in a travesty of justice as bizarre as the actual event, instead of Coca-Cola's suing Mr. Green's estate for damage to its property, his family has sued Coca-Cola for negligence. In it they complain that the soft drink manufacturer "ought to have known that it was a common and reasonably foreseeable practice among young people to obtain free drinks from the defendant's dispensing machines by tilting the machines forward."

Nor is this merely a nuisance case. James Drum, technical vice-president for Coca-Cola Ltd., thinks enough of it to have replied that the industry is studying ways to bolt down the dispensing machines. "We're working on it as diligently as we can," he said.

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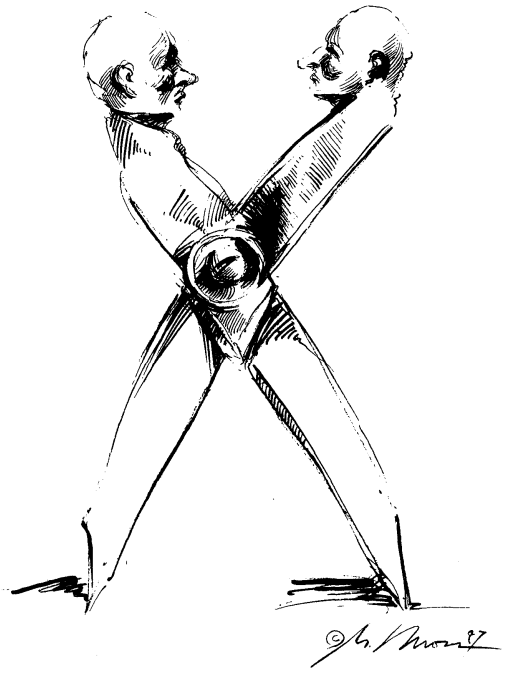

Unfortunately, such perversion of the law is by no means confined to central Canada. The British Columbia Court of Appeal has recently upheld a lower court ruling against a helicopter skiing company for delivering two men to the slopes of a lodge in the Purcell Mountains. Soon after, the two skiers died in an avalanche.

The heli-skiing company was found guilty of negligence, even though the two men were expert skiers and had signed detailed waivers relieving the company of all responsibility.

What is going on here? Has the notion of personal responsibility been banished entirely from the legal scene? What happened to the natural law doctrine of "caveat emptor," under which goods and services were sold on an "as is" basis, and the vendor took no responsibility for accidents, let alone theft on the part of the buyer?

If things continue along the present legal path, there will scarcely remain anyone in business to produce a football helmet, hockey skate, soccer ball, teeter-totter, motorcycle, swing set, sailboat, lawn mower, meat grinder, or any other equipment which might conceivably be involved in a mishap.

It is difficult to explain this movement away from "caveat emptor." But one possibility might be the influence of a new movement in law and economics which is concerned with measurement and information. In this perspective, it is of the utmost importance to reduce information costs of all kinds, but particularly those associated with risk.

Great emphasis is placed on the fact that Coca-Cola may be presumed to know more about the accident possibilities of its dispensers than would the general public, and that the helicopter company has greater information about possible avalanches than would even tourists who are expert skiers. In like manner, the manufacturers of sporting equipment and consumer machinery are assumed to be far more knowledgeable about their products than are the ultimate users.

If this is the case then, according to economists who should know better, information costs may be reduced by holding the producer responsible for any mishaps, not the consumer.

The problem with this view is that costs are subjective. Costs are the alternatives forgone through any act of choice. As such, only the individual economic actor is in a position to know what opportunities are given up when an option is selected.

Consider the helicopter case. It is wrong to assume that despite an explicit agreement between the two parties absolving the helicopter company of responsibility, that the skier is ignorant of the true costs of the risk. All we have to go on is a voluntary contract between the company and the vacationer. From this we can deduce that in the minds of both parties the agreement was worthwhile. As it turned out, of course, tragedy struck. But it does not follow that, in the future, information costs can be reduced, and the public good promoted, by setting aside contracts which incorporate the knowledge of both consenting parties.

What is needed in law circles is a healthy dose of common sense, with a pinch of respect for commercial contracts between consenting adults. □

Vanishing Voluntarism

by James L. Payne

The Planned Parenthood organization recently ran an unusual billboard advertisement in the cars of the Washington, D.C., Metro that says a lot about what is happening to voluntary groups in this era of big government. The ad shows an Asian woman and her child, with this caption: "It took a generation to give her a choice. And one Administration to take it away."

The organization was protesting about a funding problem. The Planned Parenthood Federation of America has been receiving about $20 million yearly from the federal government to carry out birth control programs abroad. Recent regulations of the Reagan Administration (concerning abortion funding) led to a cutoff of money for foreign programs. Hence the Metro ad. But unlike the usual appeals of private organizations, it doesn't ask the public for a dime.

"White House extremists have targeted Planned Parenthood's international program for destruction," it continues. "Congress can stop them. Call your representatives now. Tell them: if the extremists win, the whole world loses. Help us fight back."

Planned Parenthood may, in fact, be a fine organization doing an important job. That isn't the issue. The question is whether, as its own Annual Report claims, it is a "voluntary" agency. Inspection of its finances shows that it gets nearly 40 per cent of its funding from federal, state, and local governments. Its international program, as just noted, is dependent on the whim of government regulation. Even its fund-raising orientation has shifted. When it comes time to "fight back," it does not seek voluntary donations, but organizes a political campaign to force taxpayers to fund its programs.

How does this loss of independence come about? "We were approached by the government," one embarrassed PPFA staffer told me. Looking around at other organizations, it seems this is the typical pattern. In their eagerness to do good, politicians and administrators seek out healthy, appealing voluntary activities and turn them into government "programs."

Take, for example, the ACTION agency. This governmental unit administers "The Domestic Volunteer Service Act of 1973." In what sense, one wonders, are we talking about "voluntary" action? A government agency, funded by tax money, is administering an Act of Congress, a law backed by the enforcement powers of the United States Government.

Well, you say, at least the workers in the program are volunteers in the sense that they don't get paid. Guess again. The "volunteers" in most of the programs are paid a wage, politely called a "stipend," which typically runs to $2.20 per hour (tax free), along with other benefits.

Just how far we have strayed from the ideals of voluntarism was sharply demonstrated a few years ago when Senator Jesse Helms' Agricultural Subcommittee on Nutrition held hearings on "Private Sector Initiatives to Feed

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America's Poor." The Senator called the hearing "to gather information on efforts being made by the private sector . . . in addressing the food needs of the poor." But it turned out that the overwhelming majority of the witnesses urged continuation and expansion of the federal government's food programs. One even called on Congress to "legislate an end to hunger"!

Not Private at All

As they described their own "private sector initiatives," it became clear that many were not private at all. Like the Planned Parenthood programs, they were extensions of government. For example, one minister from North Carolina explained the many governmental ties in his church's programs: they depended on the county welfare office to certify the needy, they equipped their kitchen with a grant from the North Carolina Division of Aging, they obtained a $580,000 loan from the Farmers Home Administration and another, for $2.5 million, from the Department of Housing and Urban Development, and so on.

Rather than being apologetic about taxpayer funding of his organization, the minister took credit for expanding governmental dependency. Near his city, he said, is "a rural, mountainous area where many people live below the poverty level. These people are poor, but they are also proud. Many of them would rather die of malnutrition than to accept the Government dole. Thus assistance must come to them in an acceptable form, one which honors their dignity and their personhood. The church is an ideal conduit for assistance. . . ."

Thus we see the "private sector" reducing itself to a front for government funding.

Some would say that such "public-private partnerships" are healthy, a creative adaptation to the welfare needs of the 1980s. But this view overlooks the distinctive character of truly private action. In private, voluntary groups, no one uses force to make anyone do anything. People join up and give money because they believe in the aims of the organization, because they have been persuaded to help. For idealists seeking to reduce the role of force in human affairs, voluntary organizations are the key to a brighter future with less coercion.

Government, by definition, involves the deployment of force. Government funds are collected not voluntarily but through coercion or the threat of coercion. It may be necessary to do things this way, at least under certain circumstances, but coercion can't be considered a high-minded approach, nor the wave of a desirable future. Government is a tainted realm of things "belonging to Caesar." Impoverished North Carolina hill folk understand this, and that is why they are chary of government welfare.

The leaders of private organizations need to face this awkward truth. At first glance, government can look like any other donor when it is offering funds. But one has to ask how it gets the money, and whether a "voluntary" organization ought to be a part of that system. □

IDEAS ON LIBERTY

Virtues and Values

Liberty, individualism, voluntarism, personal independence, and individual responsibility can only be made to work by a people who have developed virtues which will buttress these ideas and practices. For people in general to concur in practices by which each man receives the fruits of his labor, they need to have a set of values in keeping with these practices. These values must exist in intricate interrelation, not in careless disarray.

CLARENCE B. CARSON

The World Bank vs. the World's Poor

by James Bovard

The World Bank is helping Third World governments cripple their economies, maul their environments, and oppress their people. From Benin to Zaire, the bank has spurred the nationalization of Third World economies and increased political and bureaucratic control over the lives of many of the world's poorest people.

The bank—officially known as the International Bank for Reconstruction and Development—was organized by the United Nations in the closing years of World War II. Its mission, according to its Articles of Agreement, was to facilitate "the investment of capital for productive purposes . . . to promote private foreign investment by means of guarantees . . . and when private capital [was] not available on reasonable terms, to supplement private investment. . . ."

Until the late 1960s, the bank was a conservative institution that primarily funded infrastructure and other basics in less-developed countries. Then, in 1968, Robert McNamara became bank president, and dedicated the bank to continually rising loan levels. Between 1968 and 1981, when McNamara resigned, loan levels increased from $883 million to $12 billion, and have continued soaring since.

Bank officials are now leading a rhetorical crusade in favor of the private sector. But, more than any other international institution, the bank is responsible for the rush to socialism in the Third World—the rise of political power over the private sector—and the economic collapse of Africa.

The bank is seeking a $10 billion commitment from the U.S. government to allow it to greatly expand its lending. Now is the time to stop U.S. support—and to give struggling Third World economies a better chance for survival.

The Assault on Human Rights

The bank has a long record of supporting human rights violations. In the early 1970s, for example, the government of Tanzania, with bank aid and advice, implemented a "villagization" program. The Tanzanian army drove peasants off their land, burnt their huts, loaded the people onto trucks, and took them where the government thought they should live—where they were ordered to build new homes "in neat rows staked out for them by government officials." (*Washington Post,* May 1, 1976) The Tanzanian government wanted to curb the people's individualistic and capitalistic tendencies and make them easier to control.

In many cases, the new government villages were a great distance from the farmers' fields, so the farmers simply quit tilling the land. This, in no small way, has contributed to Tanzania's recurrent hunger problem.

In August 1978, the bank loaned $60 million to the government of Vietnam—even after widely circulated reports of massive concentration camps and brutal repression. The bank in-

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directly paid for the abolition of private farms and the creation of huge state cooperatives. Many farmers who resisted the government's "reorganization" were sent out in leaky boats. Thousands drowned.

The bank has loaned the government of Indonesia over $600 million to remove—sometimes forcibly—several million people from the densely populated island of Java and resettle them on comparatively barren islands. Despite widespread reports of violence, the bank continues lauding the project as "the largest voluntary migration" in recent years.

The Indonesian Minister of Transmigration has proclaimed that "by way of transmigration, we will try to realize what has been pledged, to integrate all the ethnic groups into one nation —the Indonesia nation. . . . The different ethnic groups will in the long run disappear because of integration and there will be one kind of man." (*Washington Post,* June 24, 1986) As Australian critic Kenneth Davidson notes, transmigration is "the Javanese version of Nazi Germany's lebensraum." (*Melbourne Age,* June 1, 1986)

The World Bank is providing massive aid to the Ethiopian Marxist regime of Mengistu Haile Mariam. In the midst of the 1984-85 famine, the government launched a "resettlement" program to forcibly move hundreds of thousands of Ethiopians from the northern parts of the country to the south. According to Doctors Without Borders, a French medical assistance group, the resettlement program may have killed more people than the famine itself. (*Washington Post,* December 3, 1985)

Mengistu is also committed to a villagization program whereby the government forces people to abandon their private land and live in government-controlled villages, complete with guard towers. Three million Ethiopians already have been moved this way, and the government claims that eventually it will resettle 33 million people in government villages—three quarters of Ethiopia's population.

The Wall Street Journal recently reported (May 27, 1987): "Ethiopian soldiers seized their land, destroyed their mosques, burned copies of the Koran and tried to force them to live in villages and give their produce to a collective, in return for standard food rations." The villagization scheme is closely tied to the government's plan to nationalize all agriculture.

Throughout this period, the World Bank has provided massive aid to the Mengistu government. Bank commitments to Ethiopia in 1985 equalled roughly 16 per cent of the government's $1 billion budget. The bank has provided millions for the Ethiopian Ministry of Agriculture, despite its involvement in the villagization scheme. One disgruntled bank employee, who wished to remain anonymous, described the bank's Ethiopian policy as "genocide with a human face." (personal interview, August 6, 1987)

A Record of Failure

As the bank's 1987 annual review noted, 75 per cent of its African agricultural projects have failed, bank projects in Latin American and Africa routinely collapse because the governments don't repair the bank-financed roads and infrastructure, and World Bank officials have suffered from "an unseemly pressure to lend" to Third World governments. (*Twelfth Annual Review of Project Performance Results,* World Bank, 1987)

World Bank money has probably had its biggest impact in Africa. Between 1973 and 1980, the bank plowed $2.4 billion into African agriculture. For almost 15 years, the bank has concentrated on boosting food production; in the late 1970s and early 1980s, 92 per cent of bank projects were designed to increase food production. (*Tenth Annual Review of Project Performance Results,* World Bank, 1985) Yet, per capita food production has fallen almost 20 per cent since 1960.

A 1981 Bank analysis of Africa concluded that "Much of the investment in agriculture, especially the domestic component, has gone into state farms, big irrigation schemes and similar capital-intensive activities. These have turned out to be largely a waste of money; their impact on output has been negligible in most cases." (*Insight,* February 9, 1987)

World Bank aid and advice helped African governments launch a flood of new public enterprises. But, as a 1986 bank report concluded, these enterprises "present a depressing

picture of inefficiency, losses, budgetary burdens, poor products and services, and minimal accomplishment of the noncommercial objectives so frequently used to excuse their poor economic performance." Moreover, "the overall performance of public enterprises is so poor that even those African governments most philosophically committed to socialist principles are now openly voicing concern." (John R. Nellis, "Public Enterprises in Sub-Saharan Africa," World Bank, 1986)

Bank support of African state-owned enterprises undercuts the private sector in other ways. A 1987 bank study notes: "Another prevalent weakness in African trade regimes is the granting of import duty exempts to government enterprises and foreign aid financed projects. This practice subjects private enterprises to unfair competition and retards the development of domestic industries capable of making the same products, especially when such exemptions coincide with currency overvaluations and heavy domestic tax burdens on local producers." (Keith Marsden and Therese Belot, "Private Enterprise in Africa," World Bank Discussion Paper no. 17)

Even though World Bank studies and spokesmen repeatedly insist that the private sector is inherently more efficient than the public sector, the vast majority of Bank lending is still going to shore up foundering state-owned enterprises, government credit institutions, and political and bureaucratic control of Third World economies.

But such aid works against real private-sector-oriented reform. As Alan R. Walters, former chief economist for the Agency for International Development, notes, "Foreign aid . . . gives enormous resources and control apparatus to the local administrative elite and thus sustains the authoritarian attitudes corrosive to the development process." (*Washington Times,* March 6, 1987) P. T. Bauer of the London School of Economics recently observed, "Third World rulers' policies, which have been supported for decades by official Western aid, accord with their own interests. They will modify them only if continued pursuit promises to result in economic breakdown threatening their political survival." (*The New Republic,* June 15, 1987)

Bankrolling Communism

Loans to communist governments have been the fastest growing part of the bank's portfolio in the 1980s. An aid agency desperate to find new recipients has found them in the worst managed economies in the world.

The bank has plowed over $4.7 billion into Yugoslavia. Today, the Yugoslavian economy is in shambles, inflation is over 120 per cent, and the economy is so rigid and controlled that the different states of Yugoslavia have almost no trade with each other.

Since Hungary joined the World Bank in 1982, the bank has given it over $1.3 billion in subsidized loans. Hungary recently received a $140 million loan to "help the government maintain the momentum of the reform process and the restructuring of industry." (Bank News Release, June 15, 1987) But Hungarian reform is largely an illusion and a failure. (See James Bovard, "The Hungarian Illusion," *The Freeman,* September 1987.)

China is now the bank's second largest borrower, after India. The bank rushed into China as soon as Beijing announced that it would consider accepting foreign loans, and the bank has been searching for justifications for its China binge ever since. In a 1984 statement, a bank official asserted, "If China is to maintain a reasonable growth rate and manageable debt service payments, it will need to obtain the necessary additional foreign capital at an average interest rate below the market rate." (Helen Ericson, "World Bank to Boost China Loans," *Journal of Commerce,* January 6, 1984) In other words, the Chinese economy is so poorly managed that it needs subsidized loans.

Now the Soviet Union appears to be on the verge of gaining World Bank membership—and subsidized loans. World Bank president Barber Conable has stated that he would be "happy" to consider Soviet membership, and Undersecretary of State John Whitehead has said that the U.S. "would like to see the Soviet Union become a member of" the World Bank, the International Monetary Fund, and the General Agreement on Tariffs and Trade. (*New York Times,* March 6, 1987)

World Bank projects have often caused great environmental harm.

In Kenya, the World Bank has invested over $29 million in the Bura irrigation project. But, when President Moi toured the site recently, he found "eroded irrigation canals, abandoned plots, poor crops, tumbledown and unsanitary housing, zebra grazing on irrigated land, and an air of general desolation and decay." According to *African Business,* "a confidential World Bank mid-term evaluation reported at the beginning of 1985 that Bura's tenants, aside from being so disaffected that a fifth of them had deserted their plots, suffered mortality and morbidity [rates] several times higher than the national average." Even though the project had invested almost $50,000 per family, the bank report noted severe and widespread malnutrition among "beneficiaries." (Barbara Gunnell, "The Great Bura Irrigation Scheme Disaster," *African Business,* April 1986)

The bank recently made a $450 million loan to Brazil for hydroelectric projects, even though the bank's president conceded that one of the dams was "an ill-conceived project which has had substantial negative effects on the environment and on the AmeriIndian population." (A. W. Clausen letter to Bruce Rich, June 26, 1986) Hugh W. Foster, U.S. representative to the Bank's Board of Executive Directors, complained that the loan is "pure folly," that it will finance "a series of environmental disasters," and that resettlement efforts are sure to bring "extensive human suffering and bitter recriminations." (Statement to the Board of Executive Directors, June 19, 1986)

The bank is spending almost half a billion dollars to dam up the largest westward-flowing river in India, a massive scheme that will displace over two million people, flood 900 square kilometers, and destroy 33,000 hectares of the country's dwindling forest cover, including some of its best teak and bamboo. A study by the Indian Council of Science and Technology predicted that the dam will result in increased malaria, cholera, viral encephalitis, and other water-borne diseases. (Ashish Kothari, "This Dam Spells Doom," *Express Magazine* (India), September 22, 1985)

Conclusion

After scores of World Bank loans, most less developed countries still have policies that would qualify them for an economic insane asylum. If the bank has not straightened out Third World economic policies after disbursing over a hundred billion dollars in loans and handouts, what chance is there that increased bank lending will correct the problems in the future?

The World Bank claims that adjustment requires austerity, and we must give governments extra aid to help them adjust. But, in most cases, what is needed is not belt-tightening but simply that governments loosen the noose around their own economies.

Western governments cannot wrap themselves in a cloak of virtue because of their World Bank donations. At the same time Western aid to Third World countries has increased, the United States and Europe have raised new barriers against Third World imports. First we give them money to make them more productive, and then we refuse to allow them to sell us what they produce.

It would be more beneficial, and far more effective at encouraging healthful Third World economic policies, if we simply stopped giving handouts and simultaneously abolished trade barriers against Third World imports. Dominican Republic farmers, for example, would benefit more from open access to our sugar markets than from a handout to their government. And Americans, instead of being taxed to underwrite boondoggles in Timbuktu, could buy goods at lower prices. Free trade would mean less waste and more efficiency here and abroad, rather than higher taxes here and more government intervention throughout the world. □

A Visit to Nicaragua

by Lawrence W. Reed

Last November, three colleagues and I visited Nicaragua for a week. It was the time when the democratization requirements of the Central American peace plan were to take effect. The place was crawling with American reporters and politicians.

It was also the week in which the fallout from a high-level defection kept Managua buzzing with both fact and rumor. Major Roger Miranda, chief staff officer to the country's defense minister and privy to the government's most classified secrets, had fled into the waiting arms of the American CIA with documents galore. The Costa Rican ambassador to Managua told us that Miranda's defection had the Sandinista leadership biting its nails and burning the midnight oil.

But as the government of President Daniel Ortega struggles to contain the Miranda damage, comply with the demands of its Central American neighbors for peace and democracy, and turn back the increasingly popular appeal of the "Contra" rebellion, it faces a problem potentially more threatening than all the others. Nicaragua's economy is rapidly descending into utter chaos.

"By every economic measure imaginable," reports *Time* magazine (November 16, 1987), "the country has become considerably poorer" since the Sandinistas brought their Marxist agenda into play in 1979. The purchasing power of the average person with a job (many have none at all except what they conjure up illegally) is less than 10 per cent of what it was just seven years ago.

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Almost everything is allocated according to a tightly controlled rationing system. Each family is limited to two bars of soap, two rolls of toilet paper, one stick of deodorant, and one small tube of toothpaste per month. Milk, sugar, and chickens are rationed, too, but often are not available at all for many days at a time.

The rice ration has been cut to one pound per person per month, down from five pounds three years ago. Armed militiamen check each shopper's bag as he leaves the store to be sure no one "deviates" from the plan.

If you're a Nicaraguan lucky enough to have a car, you're entitled to no more than 17 liters of gasoline for a whole month. Ration stamps for the precious fuel are adorned with pictures of the deceased Carlos Fonseca, a Marxist who helped found the Sandinista organization in Havana, Cuba, 26 years ago.

Lines at gas stations are often more than 50-cars long. People literally push their autos for hours, one car-length at a time, as they advance in line with no assurance that the gas won't run out before they get to the pumps.

One of our cab drivers, a middle-aged man named Armando whom I had befriended on an earlier visit in April 1986, said 17 liters of gas "only lasts me two days." The rest of the gas he needs he finds on the black market, a network of illegal transactions which most Nicaraguans now utilize in order to survive.

"When my car finally breaks down," Armando told us, "that's when I'll make my plans to leave the country." Spare parts are impossible to find or too expensive to buy, which explains why Managua streets look like a vast and mobile auto junkyard.

A special segment on PBS's *McNeil-Lehrer News Hour* last November 13 made the point that in shortage-plagued Nicaragua, "among the few things that always seem to be available are the complete works of Marx and Lenin." On many occasions, Sandinista officials have proclaimed that the doctrine of Marxism-Leninism is "inseparable" from their ongoing revolution. We saw lots of the stuff all over Managua.

Just because something is on the shelf, however, doesn't mean it's affordable. Inflation is so bad in Nicaragua that prices quoted this week are almost sure to be obsolete next week.

Reliable economic statistics are nonexistent in the country, but most estimates put the inflation rate at more than 1,000 per cent and accelerating.

In April 1986, one American dollar fetched 800 Nicaraguan *cordobas* at the legal rate, 2,000 on the black market. In November 1987, the official rate was 9,500 while on the street the rate was 18,000.

Last October, the government emptied its warehouses of unused 20-*cordoba* notes. Because today's prices make such a small denomination essentially worthless, the government added three zeroes to make each note 20,000 *cordobas*. It used black ink stamped on the face of each note. The money supply was thereby expanded enormously all at once. On the very day we departed the country, most prices were scheduled to triple.

Government Controls

Under the Sandinista program, virtually all prices and wages are fixed by the central government. Farmers must sell nearly all their production to the government at prices it decrees. No one imports or exports except through the government. The bureaucracy is so all-encompassing that Nicaraguans complain about having to be screened by local Sandinista political committees before they can even apply for a driver's license.

Ask ordinary citizens who is at fault for the economic crisis and overwhelmingly one finds the government, not the war, is blamed. More than one person noted that Nicaragua had war under Somoza (the ousted dictator) for a longer time than under the present government, but things never got anywhere near as bad as they are now.

One lady who had been waiting for two hours in a bread line complained bitterly, "The war has little to do with this mess; it's the government's planning that's at fault."

Many others mentioned the war with the U.S.-backed Contra rebels as a factor in the economy but said that if it hadn't been for the Sandinistas' economic and political policies, there wouldn't be a war. Sentiment for the government's official line—that the present problems are all caused by Ronald Reagan and the Contras—is not easy to find in Managua, and even tougher to locate in the countryside, where support for the rebels is broad-based and growing.

Poverty, always a problem in Nicaragua, has become pandemic. Few if any are starving, but many people are hungry and uncertain when or if their next meal will come. At a dump adjacent to Managua's famed "Eastern Market," city trucks unload garbage each morning. Whole families scavenge barefoot through the debris, sending a mass of flies in the air with every step as they search for half-eaten bits of food.

Just five minutes away, however, foreign visitors wine and dine at the posh Intercontinental Hotel. A favorite hangout for media people and pro-Sandinista foreigners, the Intercontinental features a lavish buffet every morning. The government takes good care of those who come to see what the revolution has accomplished.

By February of this year, the street value of the Nicaraguan cordoba had plummeted to 60,000 to the dollar. At that point, the Ortega government suddenly announced a three-day conversion of all "old" cordobas to "new" cordobas. All citizens had to exchange the old for the new at the rate of 1000 to 1 before the old one became worthless and illegal at the end of the three days. In a particularly draconian move, the government decreed that no one could exchange more than 10 million old cordobas; many merchants had much more than that amount. Ortega also appealed to the people to "fight inflation by refusing to buy overpriced goods or to accept jobs paying more" than those they held. He dispatched a wave of armed police to confiscate the property of "unlicensed merchants, speculators and black marketeers."

The economy of this Central American nation of 2.5 million people is a first-class basket case and getting worse. The implications for the Sandinista government are ominous. Massive infusions of aid from its Soviet and East-bloc comrades and a repressive political system may not be enough to stave off the kind of turmoil that has brought down other governments around the world. If the Contras don't get rid of the Sandinistas, as one political figure in Managua put it, maybe the economy will. □

Africa and the Difference Between Growing Food and Eating It

by David Osterfeld

A recent article dealing with the food problem in Africa lamented the fact that "in 1984 140 million of its 531 million people were fed entirely with grain from abroad" and that "in 1985 the ranks of those fed with imported grain may have reached 170 million."[1] The article is hardly unique. In fact, studies dealing with Africa's deteriorating economic plight almost invariably focus on the continent's declining agricultural output.

The problem is that, *by themselves,* the figures prove little or nothing. In fact, historically, the conversion of cropland to nonfarm use has been a sign of economic advance. There is little doubt, for example, that the average American is better fed today than, say, in 1776 when a much larger proportion of the cleared land was devoted to agriculture and over 90 per cent of the people were farmers. By the same token, the average American is better fed today than he was in 1776, even though only about 3 per cent of the population is directly involved in farming.

This pattern is not confined to the United States. It is a universal, historical pattern. Thus, if one could draw any conclusion from the above figures, it would be that they are an indication of economic advance in Africa, not decline.

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But, it is common knowledge that the economic situation in much of the African continent is perilous. The number of deaths from the recent famine is generally placed at one million.[2] According to World Bank data, the low-income economies of Sub-Saharan Africa have an average per capita income of only $210. And while Africa is the only continent in which incomes have fallen, averaging a 0.1 per cent decline per year for the last two decades, what is most alarming is that the rate of decline has been accelerating.[3]

How can one explain the seeming paradox between regional declines in agricultural output, which is historically associated with economic advance, and falling incomes, an obvious indication of economic deterioration?

Excluding theft, there are three basic ways in which individuals can provide for their own and their families' needs: they can (1) produce *directly* for their own consumption, i.e., engage in subsistence agriculture, (2) produce for their consumption *indirectly,* i.e., produce for the market and then use the income obtained to supply their needs, or (3) engage in some mix of the two.

Direct and Indirect Production

Direct production requires one to be the proverbial "jack-of-all-trades." And that means, to finish the proverb, that one is condemned to

be "master of none." By definition, direct production precludes specialization and economies of scale, and thus those engaged in it must forfeit all of the associated economic benefits. Thus, such forms of direct production as subsistence farming are characteristic of economically backward economies.

The simple fact is that some areas are better suited for growing certain types of food and agricultural products than other areas. Recognition of this fact opens up the possibility of specialization and gains from trade. Some farmers specialize in growing bananas while others specialize in corn. Since neither can use nor want to use all that they produce, bananas will be traded for corn or other items. But since specialization increases productivity, there is more of everything to go around. Thus, the transition from subsistence to cash-crop farming represents significant gains in utility for members of the society.

Similarly, as farm output increases and markets expand, some individuals and families find that the best use for their land lies in such nonagricultural pursuits as industry, manufacturing, or services. That is, some people discover that the best way to feed and provide for themselves is not to grow food at all, but to produce other things, sell their products, and then purchase the food they need. Production for the market—because of the tremendous gains in both productivity and utility resulting from the division of labor, specialization, and free trade—is a far more efficient method of satisfying one's needs than direct, subsistence production.

Africa's Plight

The basic "food problem" in the world today is not one of shortage but of surplus. As Barbara Insel of the Council on Foreign Relations has put it, "the world is awash in grain."[4] World-wide production of wheat and feed grains has grown 20 per cent over the last decade and 100 per cent since 1964. Many nations that traditionally have been major food importers, China and India to name but two, are now food exporters.[5] The result is that world grain stocks currently exceed 190 million tons—enough, Insel notes, to feed all of the hungry in the African sub-continent for the next 50 years.

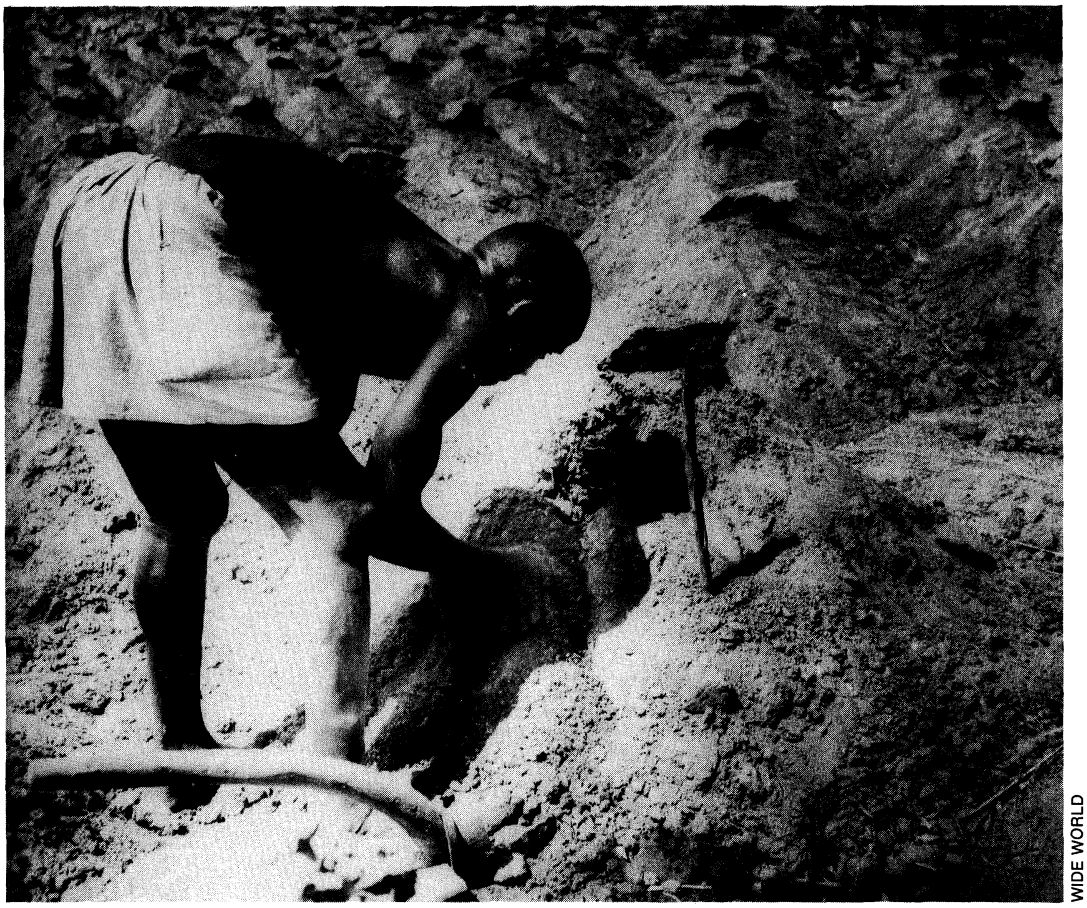
Governments in the United States and Europe have programs designed to reduce farm production. Some land in Europe and America is being withdrawn from agricultural production and, as farm productivity in these countries rises, the percentage of the population engaged in farming continues to fall. In fact, according to John Harris, owner of Harris Farms in Coalinga, California, if the United States had not experienced a cycle of very poor weather in recent years the surpluses would have been even larger. "At this point," says Harris, "farmers have become capable of producing a surplus of just about everything."[6]

Put differently, farm output could easily be increased substantially. The consensus is that the earth is capable of feeding and clothing at least 11 billion people, or twice the current world population.[7] And some authorities, such as the late Herman Kahn, feel that this is a very conservative figure.[8]

It is clear that the basic problem in Africa is not really a food problem at all. It is a poverty problem. The reason so many Africans are starving or suffering from malnutrition is not that there is a shortage of food, but that they do not have the means to purchase it. The problem, as economists put it, is a lack of effective demand. This raises the questions: Why is Africa so poor? Why is Africa the only area of the world where per capita incomes are declining?

Comparative Advantage

To deal with this question, we need to draw upon the principle of comparative advantage. While the reasons frequently offered to explain Africa's plight range from the belief that the Western nations "control" international markets and deliberately have subjected the nations of Africa to unfavorable terms of trade,[9] to the argument that Africa's workforce is unskilled and capital is relatively scarce,[10] a common argument is that Africa is poor because it simply cannot compete on the world market. Since the nations of Africa are "harmed" by foreign trade, the logical conclusion is that they would be better off severing



WIDE WORLD

Yam farming in Ghana.

their economic ties with the rest of the world. This argument is fundamentally unsound.

The economic argument for free trade is premised on the "Law of Comparative Advantage," formulated by the English economist David Ricardo (1772-1823). This law, simply stated, says that "If the greatest possible advantages of foreign trade are to be secured for all, each nation should devote itself to what it can do most cheaply."[11] In view of the foregoing objection that Africa is hurt by free trade because *everything* that it can do can be done more cheaply by other nations, the expression "what it can do most cheaply" needs careful definition.

Whether *everything* can be produced more cheaply elsewhere is debatable. It is also irrelevant to the question of whether free trade would benefit the nations of Africa. What is relevant is not *absolute* but *relative* advantage. The two are quite different.

For example, assume that Howard is both a better chef and a better dishwasher than Fred. Thus, Howard possesses an absolute advantage over Fred in both jobs. But if Howard's advantage over Fred as a chef is greater than his advantage as a dishwasher then it would be in Howard's interest to specialize in cooking, leaving the dishwashing to Fred. Similarly, if Fred were a better dishwasher than a chef, even though inferior in both to Howard, it would be in Fred's interest to specialize in dishwashing, leaving the cooking to Howard. Thus, even though Howard were better at both cooking and dishwashing than Fred, Fred would still have a *comparative* advantage over Howard in dishwashing. And both would benefit by specializing in that area where their comparative or relative costs were cheaper.

What is true for individuals is just as true in this case for nations and regions. As the British economist Roy Harrod puts it, the gain from

free trade "depends on the relation between the ratio of the cost of production of A to that of B at home and the relation of the cost of production of A to that of B abroad. *Gain is possible if the relations are different.*"[12]

Government Intervention

We can now deal with the question of Africa's continuing poverty. Three areas of the economy will be examined: (1) the farm sector, (2) the nonfarm sector, and (3) capital investment.

1. The Farm Sector. There is general agreement that Africa has tremendous agricultural potential. For example, Herman Kahn believed that Africa contains as much as 700 million hectares of *potentially* cultivatable land (one hectare equals 2.47 acres), or about three and a half times the amount currently cultivated in the United States, and more than double that in the industrialized countries of North America and Europe combined.[13] The World Resources Institute put the figure even higher, at 760 million hectares, but found that only about 160 million hectares are under cultivation.[14]

The real controversy is about the *cost* of bringing those additional areas under cultivation. Some researchers, such as Nick Eberstadt, David Hopper, D. Gale Johnson, Herman Kahn, and Doreen Warriner, believe that this can be done at relatively little cost.[15] Kahn, for example, maintained that eradication of the tsetse fly at an estimated cost of $20 billion would open up about 200 million hectares of land to cultivation. And proper irrigation would add an additional 300 million hectares. While cost estimates vary from a low of $218 per hectare to a high of just over $1000 per hectare, Kahn argued that given the productivity of the new land "such costs should be no great deterrent in a world of growing affluence, even if they should run as high as $2000 per hectare." In fact, since so much of the continent is located in tropical and semitropical regions where the growing season is quite long, much of Africa, argued Kahn, is ideally suited for multicropping.[16]

Other researchers, such as Lester Brown, Christopher Wolf, and the World Resources Institute, are not nearly as sanguine. According to the World Resources Institute, "Africa is not particularly well suited to agriculture. Over 80 per cent of its soils have fertility limitations and the climate in 47 per cent of the continent is too dry for rainfed agriculture."[17] Consequently, conversion to cropland would require massive irrigation or the introduction of new, drought-resistant crops, both of which, the Institute believes, are far too expensive for African farmers. Moreover, multicropping would result in high levels of soil erosion and rapidly deplete the soil of its nutrients, both of which would have a "significant deleterious effect" on fertility. While this could be offset by increased use of fertilizers and such methods as no-till and minimum-till agriculture coupled with the use of herbicides, the cost for most of these measures is generally more than the African farmer can afford.

If Kahn and others who emphasize Africa's tremendous agricultural potential are correct, one might ask why more land isn't being cultivated. If Africa does have a comparative advantage in agriculture, why is it the only part of the world where per capita output is falling?

The simple fact is that following independence, many African governments adopted highly interventionist if not outright socialist policies. The purpose of these policies was to stimulate the industrial sector; their effect was to penalize the agricultural sector. These policies included high taxes, often in excess of 50 per cent, on agricultural products; price controls on food; monopolistic marketing boards; the abolition of the private sale of food products and farm implements, often brutally enforced; coercively established and maintained state farms; land reforms that placed farmers' land, especially that of the more prosperous farmers, in perpetual uncertainty; and acreage limitations on the size of "private farms" that were often so low as to preclude the use of mechanized equipment.[18]

There is little doubt that these policies, which amounted to nothing short of an assault on agriculture, resulted in a drastic reduction in agricultural output. Africa was a net exporter of food in the 1930s, and self-sufficient in food during the early 1950s. But by the 1980s it was a major food importer.[19] Between 1960 and

1985 Africa's per capita food production fell by 25 per cent. There is little doubt that much, if not all, of this decline was self-imposed.

Africa lost its comparative advantage in agriculture, but the reason for the loss was ill-advised government policies which penalized farmers and discouraged investment in the agricultural sector. This is easily shown. Not only was Africa a net exporter of food *prior* to massive government involvement in agriculture, but we can observe the results of the agricultural reforms introduced by several African nations, such as Zaire, Zambia, Ghana, Togo, Nigeria, Cameroon, Madagascar, and Guinea, in the wake of the 1984-85 famine that racked the continent. Marketing boards were abolished in some countries, price controls were lifted in others, and the private sale of farm produce was reintroduced in still others. In Nigeria and Ghana, for example, prices paid to cocoa farmers tripled. In Zaire, prices for cassava tripled; those for maize doubled. Agricultural output responded to these reforms by rising almost immediately. In Ghana, for example, maize production tripled; cotton production in Togo doubled; agricultural output in Zambia rose by 20 per cent in two years.[20]

The evidence appears to indicate that Africa does have a natural comparative advantage in agriculture. Poor agricultural production has stemmed primarily, if not solely, from government policies that undermine the incentive to produce. And so long as government policies continue to be biased against the agricultural sector, the African farmer will remain poor, the investments required to increase productivity will not occur, and farm output will remain low. In brief, government policies have turned African agriculture into an economic dead end.

2. The Nonfarm Sector. There are two possibilities for the nonfarm sector. First, even if Africa has a natural comparative advantage in agriculture that has been blocked by government intervention, one would expect to find capital and labor being employed in those areas of the nonfarm sector that are the most productive alternatives to agriculture. Even though these areas would be less profitable than a freed-up agricultural sector, they would be the most profitable of the remaining areas, and one would still expect incomes to rise as productivity in these areas increased.

Alternatively, if Africa's comparative advantage lies not in agriculture but in one or more areas in the nonfarm sector, one would then expect to find factors of production entering those areas. Similarly, incomes would rise as productivity in these nonfarm areas increased and output expanded.

Either way, rising incomes would enhance the ability of people to secure food and satisfy other needs.

Unfortunately, the governments of Africa have also intervened heavily in the nonfarm sector. In their attempts to stimulate industry they have enacted high tariffs and imposed an extensive network of licensing restrictions, subsidies, minimum wage rates, and the like.[21] The results should have been predictable: since tariffs and licensing restrictions would not be required if the industries or firms had a comparative advantage, such protectionist measures mean that resources are transferred from areas in which they are more productive and into areas where they are less productive. Since the result is the artificial substitution of relatively high-cost, inefficient local production for lower-cost, more efficient foreign production, everyone, except perhaps the domestic producers, is made less well off.

Similarly, since minimum wage laws increase the cost of labor, they artificially reduce the number of jobs available, i.e., the number of individuals that firms can afford to hire. The tragedy is that the ones most hurt by such laws are the poor. Since they are the least productive members of society, they are the ones such laws price out of the job market. In short, in the name of stimulating industrialization, governments in Africa have enacted policies that benefit a privileged few while severely restricting income-earning opportunities for the members of society in general. Thus, regardless of their intent, such policies have *retarded if not completely blocked* economic development.

3. Capital Investment. Given the high rate of unemployment and relatively low labor costs in Africa, one would expect to find capitalists investing heavily in the continent. In fact, about 80 per cent of all foreign investments go

to developed countries. Of the 20 per cent invested in the less-developed countries (LDCs), almost two-thirds are concentrated in 13 countries. None is African.[22] This is not surprising, in view of the extensive restrictions imposed on foreign capital, the ideological commitment of African governments to socialist policies, the ever-present possibility of nationalization, and the loss of Africa's comparative advantage in cheap labor due to minimum wages and other interventionist measures.

In short, in the name of stimulating industrialization, African governments have pursued policies that not only have penalized economic activity in the farm sector, but have eliminated opportunities in the nonfarm sector as well. By adopting policies that retard or even prevent economic development, African governments have needlessly condemned very large segments of their populations to perpetual and grinding poverty.

Africa's Economic Future

There are three possible courses that African governments can pursue in the future: (1) continuation of the status quo, (2) economic autarky, or (3) *laissez faire*. Each will be discussed.

1. *Continuation of the Status Quo*. One possible course of action is to continue the policies currently in place. This seems unlikely for most African countries. The recent famine clearly has shown the bankruptcy of these policies, and many countries are contemplating or have already adopted reforms of some type.

2. *Economic Autarky*. A second possibility would be to adopt policies of economic autarky, or self-sufficiency. In fact, some countries currently are pursuing policies with just that end in mind. The New International Economic Order, passed by the United Nations' General Assembly in May 1974, encouraged the LDCs to adopt policies leading toward economic autarky. The Declaration, which refers to the nationalization of foreign-owned property as an "inalienable right" which is nothing more than "an expression of the . . . sovereignty of every State" is replete with such phrases as the "full permanent sovereignty of every State over its natural resources and all economic activities" and "the right of every nation to adopt the economic and social system it deems most appropriate." Such sentiments obviously are incompatible with the economic interdependence of nations. The New International Economic Order encourages the LDCs to adopt highly interventionist policies that, logically pursued, would result in economic autarky.

The Lagos Plan for Action adopted in March 1982 by the Organization of African Unity, likewise calls for "the development of agriculture" with the goal of achieving economic, and in particular, food "self-sufficiency" for the African continent.[23] And some countries are pursuing national self-sufficiency. Nigeria, for example, has banned the importation of wheat, rice, corn, vegetable oil, and most other food items. The goal, according to the Minister of Information, is "to encourage local substitutes." Nigeria hopes to achieve food self-sufficiency by the end of 1988. As a result of the ban, prices for some farm products such as cocoa have quadrupled.[24]

There is no doubt that a policy of food self-sufficiency would stimulate food production. But this only means that resources formerly employed in the nonfarm sector would be transferred to the agricultural sector. To the extent that this transfer is the result not of a *natural* comparative advantage in agriculture but of its *artificial* stimulation created by the ban on food imports, domestic resources will have been transferred from more to less productive uses. The long-run result will be that *everyone* involved, including the farmers, will be less well off. Resources will have to be transferred from industries that produce goods at a comparative advantage—industries that produce goods at relatively low cost, export them, and use the income to purchase goods and services that either cannot be produced domestically or can be produced domestically only at a higher price than the cost of imports. The resources then will have to be transferred into the production of goods at which the country is at a comparative disadvantage—goods for which the cost of domestic production is higher than the cost of imports.

Clearly, the smaller the area, the greater the harm. Thus, the collective or continental autarky proposed by the Lagos Plan for Action would be less harmful than the policy of national self-sufficiency pursued by Nigeria. This can be easily shown.

Assume that a single individual, Fred, were living in a state of autarky while the rest of the world engaged in free trade. It is obvious that Fred would suffer far more from being cut off from world trade than the rest of the world would suffer from not being permitted to trade with Fred. Conversely, while both Fred and the rest of the world would gain if the ban were lifted, the gains to Fred would be immensely greater than the gains to the rest of the world. Put differently, if trade is opened between two formerly isolated markets, individuals in both markets will gain but those in the smaller market will tend to reap the larger benefits. And the greater the difference in the size of the markets, the larger the gains to those in the smaller market. This is what Roy Harrod has termed "the importance of being unimportant."[25] Thus, while the policy of continental autarky would be damaging to the people of Africa, it would not be nearly as damaging as Nigeria's policy of national autarky would be to the people of Nigeria.

A policy of economic autarky must, of necessity, forgo numerous possible gains from trade, thereby making everyone, but especially the people of the nations pursuing such a policy, worse off. Recent World Bank studies on the impact of protectionist measures support this conclusion. Both the industrialized market countries and the LDCs would reap significant benefits from "liberalization," i.e., the elimination of tariffs and other protectionist measures. But "the main beneficiaries of unilateral liberalization," according to the World Bank, "are the liberalizers themselves."[26]

3. *Laissez Faire*. A final possibility is a move toward *laissez faire*—the elimination of all measures, domestic and foreign, prohibiting the free movement of people, goods, and capital. By removing all obstacles to the movement of factors of production, such a policy would increase the efficiency of the world market by allowing all factors to be employed in their most value-productive uses. By increasing the number of goods and services produced in the world, the enhanced efficiency would benefit everyone but, once again, the residents of the LDCs in particular, since these countries tend to be more interventionist than the more developed industrialized countries.

Again, studies by the World Bank support this conclusion. The World Bank classified countries according to their degree of "price distortion" or market intervention. It found that the greater the degree of intervention, the slower the rate of growth. Those nations with a "low distortion index" had a rate of economic growth that was more than double those with a "high distortion index" (6.8 per cent vs. 3.1 per cent); the savings-to-income ratio in those countries with a low distortion index was almost twice as high as in those with a high distortion index (21 per cent vs. 13 per cent); the annual industrial growth rate in the low distortion countries was triple that in the high distortion countries (9 per cent vs. 3 per cent); the growth in agricultural production was considerably higher for the former countries than the latter (4.4 per cent vs. 2.4 per cent); and the annual export volume increased almost ten times faster in the low distortion countries than in the high distortion countries (6.7 per cent vs 0.7 per cent).[27]

The conclusion seems inescapable. The solution to Africa's "food problem" lies in solving its "development problem." And the solution to its "development problem" lies in adopting a policy of *laissez faire*. Only through a policy of *laissez faire* is it possible to determine precisely where Africa's natural comparative advantage lies. And allowing individuals the freedom to pursue what is in their comparative advantage is the best and quickest road to economic development. Whether it lies in the production of food for domestic consumption, the production of food for export, or in nonfood production is irrelevant.

If Africans can earn higher incomes by exporting food or other products than they can by growing food solely for domestic consumption, so much the better. For the higher incomes mean that they are in a better position to satisfy their own and their families' needs than they would be if they were to grow food strictly for

domestic consumption. Even though it may seem paradoxical, growing food may not always be the best way for hungry people to feed themselves.

For the past two decades most African nations have pursued highly interventionist policies. The bankruptcy of interventionism was clearly revealed by the recent famine. As a result, many nations have been forced to reassess their economic policies. Two alternative paths are possible. They can move farther down the interventionist road to complete autarky, or they can reverse their course, begin to dismantle their interventionist programs, and move in the direction of *laissez faire*. Both economic analysis and the empirical data show that only a policy of *laissez faire* offers real hope for improvement.

Some have objected that because of such disabilities as Africa's reputation for a poor business climate, its lack of a skilled workforce, pervasive political corruption, and the sorry state of the continent's "infrastructure," (roads, harbors, etc.), integration into the world market would consign Africa to a strictly "marginal role."[28] This may be true for the present. But that does not alter the fact that *laissez faire* remains the best and quickest road to economic development. Moreover, the objection ignores the fact that what is in an individual's or a region's comparative advantage today may not be in its comparative advantage in ten or fifteen years. Economic circumstances change, and it is precisely a policy of *laissez faire* that, by facilitating the efficient allocation of resources and encouraging savings and capital investment, is necessary for Africa to overcome these disadvantages and escape from its "marginal role."

In short, the path to overcoming Africa's food crisis is economic development. And the path to economic development is a policy of *laissez faire*. □

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Home-Based Work: New Opportunities for Women?

by Joanne H. Pratt

The activities of women in the labor market reveal two contradictory trends. On the one hand, women are better educated and have more job skills and training than ever before. On the other hand, a substantial number of women are leaving executive suites and returning home to have children and care for their families.

Is there a way for women to resolve the conflict between the career goals for which they have been trained and the family goals that many want to pursue? For many women, the answer is home-based work. Surveys show that:

- As many as 23 million people are using their homes as a place of work.
- Among businesses that are run exclusively out of the home, more than 70 per cent are run by women.

Women are taking advantage of a number of important economic and technological trends. Advances in computer technology mean that millions of workers can "telecommute" from their homes. The growth of the service economy is opening the doors for millions of small businesses. Most are being launched from the home.

- Of the 8.2 million sole proprietorships in the U.S. in 1980, 63 per cent were located in someone's home.
- While the number of new sole proprietorships is increasing at a rate of 3.7 per cent per year, those started by women are increasing at a rate of 6.9 per cent per year.

Despite the enormous economic and social benefits created by home-based work, those who work from their homes face a maze of legal uncertainty arising from Federal, state and local regulations.

Local Laws. About 90 per cent of all U.S. cities place restrictions on home-based work. These include requirements that no outside employee may work in the home; only one family member may work in the business; only one business may be operated from each home; only one room of a house may be used for business purposes; a separate entrance must be maintained for business customers, and no business inventory may be stored in a garage. Among the many and sometimes bizarre regulations:

- In Blaine, Minnesota, a home-based tutor in math, English or a foreign language may not tutor more than one student at a time.
- In Long Beach, California, ministers, priests, and rabbis may not give religious instruction in the home.
- In Dallas, Texas, home-based businesses may not be listed in the yellow pages of the telephone directory.
- In Danville, Illinois, no one may sell goods in a home other than by filling an order previously placed by telephone.

Joanne H. Pratt's studies of home-based workers have been published extensively in scholarly and trade publications. This article is adapted from her report, "Legal Barriers to Home-Based Work," published by the National Center for Policy Analysis, 7701 N. Semmens, Suite 800, Dallas, Texas 75247.

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An Indianapolis seamstress in her workshop at home.

- In Southern Pines, North Carolina, there is a total ban on retail sales in the home and no inventory may be displayed in the home.
- In Downey, California, a garage may not be used for home-based work.
- In Rockford, Illinois, there can be no more than one home occupation in any single residence.
- In Chicago, there is virtually a total ban on home-based work, including a ban on connecting a home computer to an office computer.

State Laws. Many states ban entire categories of products from home production. These include cigars, artificial flowers, articles of food and drink, toys, dolls, bandages, purses, feathers, children's clothing, and cosmetics. When home production is allowed, it is often restricted to a small part of the labor market:

- In Hawaii and Illinois, the only people allowed to work in the home are people who are unable to leave home.
- In Massachusetts, no one under contract with an employer or business outside the home may produce goods in their home.

Federal Laws. After a protracted court battle, the U.S. Department of Labor has managed to liberalize restrictions on home knitting. However, Federal law still bans home production (for sale) of women's garments, embroidery, handkerchiefs, jewelry, buckles, mittens and gloves.

Many of these regulations needlessly interfere with valuable economic activity and have no apparent valid social purpose. They threaten to stifle one of the most important and growing sectors of our economy, and to place obstacles in the way of the economic and social goals of an ever-increasing number of women. □

Campus Activities: Who Pays the Bills?

by Joseph S. Fulda

During my undergraduate years at The City College of New York in the late 1970s, I had some interesting experiences with student clubs, and I began to re-examine the whole matter of student activities and the way they are funded.

There seem to be four ills affecting student organizations which, according to friends and subsequent experience, appear to be pervasive on our nation's campuses.

First, the members of some clubs share few interests to draw them together. They do understand, however, that any group of students may organize and register with the student government and the college administration and thus receive a portion of the mandatory student fees collected by the college at the start of each semester. Thus I recall sitting through a two-hour meeting of a campus honor society where the sole topic of discussion was how to dispose of the generous sum we had been allocated. The debate might still be raging had it not been decided to spend it all on a grand party at the home of a student leader.

The second problem with many student organizations is that the leadership has little incentive to adhere to organizational charters. I recall one prayer-and-snack organization with a charter mandating annual elections. Yet several successive presidents simply appointed the other officers and their successors. When I pointed out to an officer that this was improper, I was asked whether I would prefer the secretariat or the treasury! "Private life," I replied. Of course, nobody really cares enough to take recourse. I didn't. After all, the monies are just there.

Third, club officers frequently divert funds for their own use: pencils, postage, bus fare, meals, maybe a month's rent! Our student newspaper, *The Campus,* was often filled with the latest scandal.

The fourth problem is that mandatory student fees distribute the costs of campus activities with an artificial uniformity. Those who care little about student activities subsidize the average user, while those who are very active are subsidized by the average user. The distribution of benefits is even more artificial. Typically, the student government decides on the apportionment of funds in its own inimitable way. Club officers must beg, cajole, and argue for funds. As I recall quite well, this leaves much to be desired.

Now there is quite a simple solution to all these problems. Why not limit student fees to cover such widely used items as the student center, athletics, and the student media? Maybe a piddling sum could be granted to the student government, too, for its advisory role. The remaining student organizations would be funded

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solely by membership dollars. With the money from student activity fees returned to student pockets, it would be up to the individual whether or not to form, participate in, or pay dues to any club.

Notice how this simple measure addresses all the problems we have sketched. First, clubs whose members share no common bond would quickly dissolve, since their reason for existence—access to mandatory student fees—would be removed.

Second, when the members must pay dues, officers will be held accountable. "Taxation without representation," unless the officers maintain a consensus, would not be tolerated. If members are sufficiently dissatisfied with their club leaders, or with the way their money is being spent, they may simply withdraw along with their financial backing.

Third, the cost of campus activities to each student would depend on how much he used them. But because the overhead of the student activities bureaucracy can be eliminated—including student government oversight functions and some college administration supervision—the typical student user would end up paying less in dues than he saved in fees.

Last, the distribution of student funds would be done naturally, not artificially. The most popular clubs would receive the most money. And no clubs would be indebted to the student government or the college administration for their funds. They would answer only to their members. And that is how it should be. □

Readers' Forum

To the Editors:

Professor Russell Shannon's essay, "Tear Down this Wall" in the January 1988 "Freeman" was idealistic and naive. His essay advocates open borders so that illegal aliens can freely enter the United States.

I shouldn't have to write the next paragraph, but I will anyway because I want your readers to know I am not a person who is afraid to see nonwhite immigrants enter this country.

My wife and I sponsored two Vietnamese families 12 years ago. This included bringing them into our home, food, money, clothing, buying them an auto and training them to drive it and finding jobs for them. Most of six months was spent getting these families on their feet. We're glad we did it and today "our" families are doing well and an asset to America.

But "open borders" won't work because of the social welfare system in place in the United States. Not all illegal aliens come to America for liberty and a job.

The United States provides such stunning incentives as free school, free lunch, food stamps, free health care, subsidized housing, unemployment compensation, Aid to Families with Dependent Children and many other freebies. The total package, even for an alien without a job, could well be many times what he could earn at home. And don't believe for a minute that the "invisible hand" of the free market would cause them to move on or go home if they didn't find a job here. Being rational they would recognize that the cost of departing would be too great. It's just too good a deal. That's why 88% of recently arrived refugees (first 31 months) in California are currently on some kind of county, state or federal welfare.

Cancel the welfare and then we can open the borders. Immigrants will then come to America for liberty and opportunity as they did a hundred years ago.

—*William F. Kerschner*
Elm Grove, Wisconsin

Professor Shannon replies:

I have no problem at all with Mr. Kerschner's argument that it is *not* desirable for us to have aliens flock here in order to become free loaders on our welfare and social service systems. By all means, let's make such people ineligible for these programs!

In practice, however, this may be difficult or impossible to accomplish. So, as an economist, I must ask: do the *overall* benefits of open immigration outweigh these (and other) costs. Several studies indicate that, indeed, the benefits do predominate. For more details, I recommend again reading the article entitled "What about Immigration?" written by Julian L. Simon which appeared in *The Freeman* for January 1986.

Finally, let me point out that the new immigration law, which now penalizes employers for hiring improperly documented aliens, has the regrettable feature of excluding immigrants who truly want to work. At the very least, we should hasten to tear down this portion of our wall.

—*Russell Shannon*
Clemson, South Carolina

Property Rights and Eminent Domain

by John Hospers

Ellen Frankel Paul's *Property Rights and Eminent Domain* is an exemplary work of both historical scholarship and creative thought. It is a valuable historical and critical survey of dozens of U.S. court decisions involving property rights, and at the same time a philosophical defense of a theory of natural rights in property.

A long historical chapter, which occupies more than 100 pages, considers two legal concepts—eminent domain and police power—which between them have produced a devastating erosion of property rights in America. Eminent domain—the confiscation of private property for public use—seems to many people a necessary qualification of a person's right to own and retain property in land (especially with "due compensation") to enable roads and air terminals to be built and scenic land to be preserved. But the author shows, in a detailed and sobering array of court decisions, how this bit of "the camel's nose under the tent" has led the courts to decide that the power of eminent domain extends to an enormous array of cases never originally intended by the granting of that power, each decision extending that power in ways that would not have been tolerated in prior decisions.

In 1945, for example, when the Supreme Court ruled in *United States* v. *Willow River Power Co.*, where dam construction diminished the generating capacity of a power plant, Associate Justice Robert H. Jackson wrote, "not all economic interests are 'property rights'; only those economic advantages are 'rights' which have the law back of them"—the law being presumably whatever the legislature decided to enact. But even in 1945 the court would not have gone as far as it did in *Hawaii Housing Authority* v. *Midkiff* (1984) when it mandated the sale of property from one private party to another with not even a pretense of "public use."

The author points out that the federal government does not possess police power except where it holds original sovereignty (U.S. territories, public lands, the nation's capital). But the concepts of "due process" and "the general welfare" were gradually extended out of all recognition, issuing in a series of decisions which in time gave the government police power over virtually anything it wanted, including the fixing of prices of consumer products. For example, the court used the "po-

John Hospers is a professor of Philosophy at the University of Southern California and editor of The Monist. *He is the author of numerous books and articles on aesthetics, ethics, and political philosophy.*

lice power" to approve the closing of a sand and gravel operation without compensation to the owners, by calling its action a "regulation" rather than a "taking" (which would have required the owners to be compensated for their loss). There are enough examples of this sort to chill the blood of any champion of economic liberty.

In the following chapter, Professor Paul develops a theory of property rights. She examines the theories of such historical figures as Pufendorf, Grotius, and Kant, finding each of them to be wanting in some respect. She gives a step-by-step analysis of John Locke's theory of property rights in land—that a right to ownership results from "mixing one's labor" with the portion of the earth on which one labors—and endorses it with certain amendments.

The human need without which no other needs can be met is that of survival, and survival requires mixing one's labor with the earth which one inhabits. No one's survival is guaranteed, but "for each individual, pursuing the strategy that will maximize chances of survival—that is, make it the least contingent, the least dependent upon forces beyond his control, and the least reliant upon the actions of other individuals—will provide a foundation" for the right to ownership of land. Moreover, since there are millions of persons inhabiting the earth,"grazing on the fruits of the earth will prove insufficient to sustain an abundance of human lives; therefore, production becomes a necessity." And since the maximization of production requires long-range planning and effort, the erection of boundaries also becomes a necessity. If there were no prospect that what one produced would secure one's survival, there would be little point in laboring to produce; but with property rights, the prospects for long-term survival are vastly increased. (What Professor Paul gives us is a systematically developed version of an outline of property-rights theory presented by Ayn Rand in her essay "Man's Rights.")

Environmental Concerns

The principal questions I would raise about this work have to do with the author's chapter on environmentalism and property rights. Environmentalism is something of a mixed bag; most environmentalists seem to be a bit mad, and cry wolf too often to be entirely believed. And the court decisions the author cites are not at all difficult to criticize. The California Coastal Initiative is an obscenity, having done far more harm than good even from a utilitarian standpoint (even more, of course, from that of property rights). To delay construction of the Tellico Dam because of a supposedly untransplantable snail-darter is somewhat ridiculous (though there may be other reasons against construction of the dam). The pessimistic projections of Malthus have been refuted by history, as have the predictions of doomsayers who have said for decades that we are about to run out of energy sources. Julian Simon's *The Ultimate Resource* is a welcome counter-blast to these doomsayers, and Lindsey Williams' *The Energy Non-crisis* provides a dramatic case history (among others) of environmental folly in closing off 95 per cent of Alaska to technological development.

Yet there is occasion for deep concern, a concern which bears directly on property rights. I shall consider only a few examples of many.

The wanton destruction of animal life by human beings has resulted in the extinction of many species of animals and the endangerment of others. The reasons for alarm are not only aesthetic—that we enjoy seeing animals in the wild—but also ecological. Each species is part of a vast interdependent ecosystem which, if once disturbed, can bring on catastrophic results. One does not have to attribute rights to trees (Christopher Stone in *Should Trees Have Standing?*), or allege that every animal has a right not to be killed (Tom Regan in *The Case for Animal Rights*), nor even adopt a "species-neutral" point of view (Peter Singer in *Animal Liberation*) assuming that this is possible. Even if one is concerned only with *human* survival, the elimination of plant and animal species, and the upsetting of the balance of nature, are matters of grave concern. (See, for example, Peter Farb, *Ecology*.)

For many centuries the African savanna has been the scene of countless animals free to graze, hunt, and roam, and countries such as Botswana have not had fences and other mani-

festations of private property to inhibit these activities. Wild animals en route to their watering places today encounter the fences; unable to cross them, they die of thirst in large numbers.

Meanwhile, to support a growing human population, domestic cattle (not native to Africa) are raised in increasing numbers for export. To protect people and cattle against the tsetse fly, vast amounts of chemicals are sprayed from helicopters. The native animals are immune to the fly, but the spray poisons the vegetation and the water on which they depend. "But the residents have a right to grow cattle on their own land if they choose, don't they? There is more of a market for beef than for venison." And here the property rights in land conflict sharply with the need for retaining the natural links in the food-chain—the native plants and animals are part of a complex and interdependent ecosystem which is essential not only to the survival of thousands of species in Africa, but to human life as well.

The Amazon rain-forest, as large as the United States, is gradually being cut down to create industries and farms for a burgeoning urban population. Uncounted species of living things are destroyed and irrevocably lost in the process. "Don't Brazilians have a right to cut down their own forests if they choose to? Doesn't the land belong to them?"

But in the long view their actions are destructive for themselves and for others. The thin topsoil, once opened to the plough, goes down the rivers in the next flood, and in a few years there are only unarable scarred remains. And the disappearance of the rain-forest will almost inevitably lead to drastic climatic changes in the entire hemisphere. Farmers in the Midwest will wonder why the rains no longer fall; they will be bankrupted and America's food supply impaired. No part of the earth is an isolated system detachable from the rest of the planet.

Locke, Robert Nozick, and Professor Paul agree that no one should use this land in such a way as to harm others in the use of their land. Pollution is the example that is constantly used. But the destruction of the rain-forest, creating deserts where once the lands were fertile, is surely a far more compelling example of such harm—such use of the land imposes a drastic negative externality on others' use of theirs. Perhaps then the owners of the land have no right to cut down their forests, according to Paul's theory of property rights. But in that case, virtually any use of land anywhere in the world stands a fair chance of being harmful to productive use of land by others, perhaps thousands of miles away—and in view of this global interdependence, whose property rights would then remain secure? Sensible environmentalists need not resort to charges of "species-ism" or far-out theories about the rights of trees; they need only play their strongest card, the ecological interdependence of all the parts of the earth. □

A REVIEWER'S NOTEBOOK

Entrepreneurs vs. The State

by John Chamberlain

Burton W. Folsom, Jr.'s *Entrepreneurs vs. The State* (Young America's Foundation, Suite 808, 11800 Sunrise Valley Drive, Reston, VA 22091, 144 pp., $16.95 cloth) is about as neat a job as one could wish. To be sure, the overall thesis of the book is not new. We have had those who, like Matthew Josephson, have pinned the Robber Baron label on practically all of our Nineteenth and early Twentieth Century industrialists. Contrariwise, we have also had those who, like Allan Nevins, Robert Hessen, Louis Hacker, and John T. Flynn, have taken note that the consumer often had the last word if only because would-be monoplists could not be trusted to remain in price-fixing pools. But Folsom, with more clarity than any of the revisionists who have gone before him, has separated the great competitors from the monopolists who depended primarily on State favors. There were "political entrepreneurs" and "market entrepreneurs," and the dividing lines in retrospect are relatively clear.

Folsom finds it significant that Commodore Cornelius Vanderbilt, who broke the early Hudson River Steamboat Association and took gold-seekers to California by way of Panama and Nicaragua at cheap rates, made money where Robert Fulton and Edward Collins, who sought government grants, could not hack it. Vanderbilt went on to build the New York Central Railroad out to Chicago, becoming the richest man in America by his progressive cutting of passenger fares.

Vanderbilt was not imitated by the first railroad barons who sought to conquer the distances between the Mississippi River and the Pacific coast. As Folsom chattily puts it, the building of the early transcontinental roads makes for good reading. The story has a sound plot: four roads get charters and subsidies to build across the country. There is suspense as the Union Pacific and the Central Pacific race over the plains and mountains to meet at a golden-spike ceremony in Utah. The "all-star cast" includes U.S. Presidents, army generals and political adventurers who confront Indians on the warpath, politicians on the take, and thousands of Chinese and Irish workers.

The grab for Federal subsidies happened to be inordinately greedy. Historians have written this off, saying there was no way to get the happy ending without Federal aid. Leland Stanford and Collis Huntington in California, Henry Villard in the Northwest and the Union Pacific Credit Mobilier leaders are all excused for doing such things as "accidentally" destroying records that might have brought jail sentences.

The only trouble with the standard story is that an incorruptible man, James J. Hill, was busy building the Great Northern Railroad from St. Paul to the Pacific without a penny in subsidies at the very time that Henry Villard was going broke in spite of government aid. Where Villard had built swanky hotels and health spas in the wilderness, hoping to attract tourists, Hill sought to develop the land. He built slowly, developing exports as he went West. He imported 7,000 cattle from England and

elsewhere, giving them to settlers near his line free of charge. He set up his own experimental farms to test new seed and livestock and the use of fertilizers. As for the railroad itself, he strove for durability and efficiency, not "scenery." "What we want," he said, "is the best possible line, lowest grades and least curvature. . . ." In 1889 Hill conquered the Rocky Mountains by finding the legendary Marias Pass where Lewis and Clark had gone in 1805. By rediscovering the Marias Pass, Hill shortened his route by almost a hundred miles.

New Opportunities

What Hill and Vanderbilt did for railroading, the Scrantons of northeastern Pennsylvania and Charles Schwab of Carnegie Steel did for the iron and steel business. The Scrantons built the country's first mass-produced iron rails and poured the profits into laying out the modern city of Scranton as a challenge to neighboring Wilkes-Barre. There were tariffs on rails and other iron products, but the Scrantons did not need them.

The history of the Scrantons corroborates the theory that both upward and downward mobility are distinctively American characteristics. As entrepreneurs, the first generation of Scrantons created something out of nothing. Not all of their descendants hung on to their shares of the family wealth. But because of what the original Scrantons did thousands of Americans had new opportunities in life.

As a steel master Andrew Carnegie was not averse to taking part in price-fixing arrangements. But he had no compunctions about deserting pools where there was a prospect for "scooping the market and running with the mills full." In his competitive zeal Carnegie had the stalwart support of Charles Schwab, who lowered the costs per ton of finished steel by 34 per cent in a single year by adding sixteen new furnaces to the Homestead, Pennsylvania, plant.

When Carnegie sold his company to J. P. Morgan for $480 million, Schwab went along in the package that resulted in the creation of U.S. Steel, the first billion-dollar company in U.S. history. Morgan was not sufficiently competitive to please Schwab, who wanted to do things his own way. Accordingly, Schwab left U.S. Steel to go to work for Bethlehem Steel, which he had bought as a private investment. He moved Bethlehem away from its dependency on government contracts, adopting open hearth technology because it could produce better rails than U.S. Steel with its antiquated Bessemer facilities.

John D. Rockefeller, the founder of the Standard Oil Company, figures in the Robber Baron literature as a veritable devil. In actuality he was a pious man who spent many hours each week attending church services. As John T. Flynn has shown in *God's Gold,* Rockefeller really meant it when he put the consumer first. In 1885 Rockefeller wrote to one of his partners, "Let the good work go on. We must ever remember we are refining oil for the poor man and he must have it cheap and good." Picking up from this, Isabel Paterson said "Standard Oil did not produce kerosene to pour it down the sink."

Rockefeller made one bad move when he joined a pool called the South Improvement Company, which was prepared to pay not only rebates but also drawbacks on oil that the bigger companies had not shipped. But no oil was ever shipped by South Improvement, which quickly lost its charter. Rockefeller later admitted he had been wrong in thinking pools were an answer to inefficient production. He turned his attention to market entrepreneurship, hiring chemists to extract every dollar possible from each barrel of crude.

Bigness was Rockefeller's reward for efficiency. But, big as it was, Standard had to meet the challenge of the new gushers tapped by upstart companies in Texas. And it had to fight the Russians for the international market. Summing things up, Folsom thinks the emergence of the market entrepreneur in the period before 1920 is proof enough that we do better when the government lets people keep their own money for their own investments.

"If we seriously study entrepreneurs," says Folsom, ". . . we will have to sacrifice the textbook morality play of 'greedy businessmen' fleecing the public until at last they are stopped by the actions of the state. But, in return, we will have a better understanding of the past and a sounder basis for building our future." □

MARVA COLLINS' WAY

by Marva Collins and Civia Tamarkin

Jeremy P. Tarcher, Inc., distributed by St. Martin's Press, 175 Fifth Ave., New York 10010 • 1982 • 227 pp., $6.95 paper.

Reviewed by Bettina Bien Greaves

Marva Collins may not be a "super-teacher" as some have claimed. But she must have boundless energy. She also has a profound love of reading, a sincere interest in history, an infatuation with life, and a desire to share her enthusiasm with children. She also loves children and has a strong conviction that none is so dull that he or she cannot learn.

Mrs. Collins spent fourteen years, in inner-city public schools, learning how to teach. She worked hard to motivate her students. With kindness and praise she encouraged them to learn. She drilled them in the basics. In time her methods bore fruit; the children responded, and vied with one another to show her how much they had learned. During these years, she discovered her own love of teaching.

However, as time passed, Marva saw the attitude of teachers change. "The longer I taught in the public school system," she writes, "the more I came to think that schools were concerned with everything but teaching. Teaching was the last priority, something you were supposed to do after you collected the milk money, put up the bulletin boards . . . straightened the shades and desks, filled out forms in triplicate, punched all the computer cards. . . ." As a result, apathy prevailed alike among teachers, administrators, and students.

Yet Marva persisted in pursuing her own proven method. But her very success with students created antagonism on the part of other teachers. When Marva could no longer take the harassment, she resigned. But teaching had become her life; it was in her blood.

The black "ghetto" of Chicago had been ravaged by the riots after Martin Luther King's death in 1968. Yet it was there that Marva lived with her husband and three children. And it was there, in 1975, that Marva started her own school. When the doors opened, she had only four 7- to-9-year-olds—her own daughter plus three public school misfits.

Marva Collins likes to begin a class, even of the very young, by reading and discussing Ralph Waldo Emerson's "Self-Reliance." Life is a struggle, she says. Every youngster is responsible for his or her own future. Each one will make mistakes, but a person who doesn't make mistakes won't make anything. She seeks to instill confidence in students by saying something nice to each of them every day. And she assures them again and again that they *can* learn.

Her first goal is to teach the children to read. Drills on phonics and syllabification are chanted over and over again. She reads aloud; she asks questions; she challenges the children to think, to speak up, to write, and to compare plots and characters in the stories they read. Through simplified versions of the classics she challenges youngsters to consider ethical and psychological problems. Reading leads, tangentially, to discussions of history, geography, and the profound moral teachings of the ages. After several months her students, most of them born and raised in the black "ghetto" of the inner city, are reading, often competing with one another to discuss Aristotle and Shakespeare. Quotations from the classics crop up in their papers and daily conversations.

The success of Marva's method has been astounding. As a result, she has received nationwide attention in the press, radio, and TV. In five years, her enrollment grew from four to 200. Yet Marva says she performs no miracles. She just works hard! This book shows just how hard. It relates her struggles with the establishment, starting her own school, and coping with expansion. It explains in considerable detail just how she teaches, even listing at the back the books she uses. Anyone who is teaching, who is considering teaching, anyone who is homeschooling, or who simply loves children, will find this book fascinating. □

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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Bruce M. Evans, chairman; Thomas C. Stevens, vice-chairman; Joseph E. Coberly, Jr., vice-president; Don L. Foote, secretary; Lovett C. Peters, treasurer.

The costs of Foundation projects and services are met through donations. Donations are invited in any amount. Subscriptions to *The Freeman* are available to any interested person in the United States for the asking. Additional single copies $1.00; 10 or more, 50 cents each. For foreign delivery, a donation of $15.00 a year is required to cover direct mailing costs.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

The Way of Freedom

The human spirit seeks full and free expression in every department of life: in the spoken and written word; in music, sculpture and architecture; in sport and play. And also in work.

Man's work, when people are free, takes form as the market economy; and the free economy generates the material support the human spirit needs for its intellectual and aesthetic fulfillment.

Economic liberty makes for a broadly shared prosperity which provides the wealth a people need to build schools, churches and factories; hospitals and laboratories; theaters, concert halls, art galleries, and museums; gardens, playing fields, and stadiums.

These cultural artifacts reflect the several facets of human nature striving for full and harmonious realization; they are the fruits of freedom. Only tend to the roots, and these miracles—and more—are possible.

—EDMUND A. OPITZ

Age-21 Drinking Laws

"[T]he enactment of minimum [drinking] age laws around the country has led to an increase in illegal drinking by those under 21.

"Just as those under 21 are not stopped by law from acquiring drugs, so too do those under 21 acquire alcoholic beverages. And instead of paying higher prices in taverns, they now buy more for the same dollar in unsupervised offpremise outlets. That increase in illegal drinking may be the cause of the increase in deaths of 15-to-19-year-old drivers and passengers.

"In fact, recent data from the National Highway Traffic and Safety Administration show that the number of alcohol-related deaths of 15-to-19-year-olds increased from 3,115 to 3,540 between 1985 and 1986. In the prior years, before the very wide enactment of the 21-year-old minimum age laws, alcohol-related deaths of 15-to-19-year-olds had decreased from 4,135 to 3,115 from 1982 to 1985. In

1986, there was, therefore, a sharp reversal of the trend, possibly because of the enactment of minimum-age-21 laws and despite the continuing campaign against drunken driving.

"Those who have sought to reduce the number of fatalities by enacting laws that lead teenagers to drink more illegally on campus and off campus have created the opposite result of what they intended. More youths are dying because of a foolishly enacted law.

"As things stand now, those ardent advocates of the minimum 21-year-old law must now explain why alcohol-related deaths of teenagers and those from even a lower age group increased in 1986 after they had declined consistently for a number of years."

—JERRY STEINMAN,
publisher of *Alcohol Issues Insights,*
in a letter to *The New York Times*
(November 27, 1987)

Push the Button

Should the welfare state be eliminated all at once or phased out over time? Some of the most committed freedom devotees waffle when it comes to that question. They maintain that the immediate elimination of the welfare system would be unfair or harmful to those who benefit from the welfare apparatus.

We must never lose sight of the fact that the welfare state is founded on an immoral principle. The political process is used to coercively take the wealth and income of some and transfer it to others. The person whose property is plundered is denied the basic right to dispose of his property in the manner he chooses.

We must also take care not to doubt the efficacy of freedom and the market process. When people are unable to turn to the political system for sustenance and support, and instead must rely upon their own efforts and the voluntary efforts of others, the resulting economic vitality benefits everyone.

In Germany after World War II, Ludwig Erhard one day surprised everyone by lifting the extensive economic controls which the Allies had imposed on the German people. Despite all the dire predictions of the harmful effects Erhard's action would have on the German economy, the result was the beginning of the German economic miracle.

In the 1930s, serious doubts began to be raised about the effectiveness of the National Industrial Recovery Act, the pervasive economic controls which regulated American businesses. Many argued that the regulations would have to be removed gradually, rather than all at once, because so many people had become dependent on them. One day the Supreme Court declared the Act unconstitutional and immediately the American economy began to revitalize.

Perhaps the best example of a sudden removal of a welfare system took place when Lee surrendered to Grant at Appomattox. Prior to the Civil War, blacks in the South were provided their food, housing, employment, and other necessities of life. There were those who argued that the slaves were too dependent on the system to be immediately permitted their freedom. Nevertheless, the newly freed blacks rapidly adjusted to their new lives of liberty and self-reliance.

To eliminate the welfare state, the "button" should be pushed. Why? Because to argue for the continuation of an immoral action, even for a short period of time, is itself immoral. Furthermore, freedom works: the creative abilities of human beings enable them to respond quickly to the market process. —JGH

Arthur Shenfield at FEE

We are pleased to announce that Arthur Shenfield, eminent British economist and barrister, will be Visiting Scholar at FEE for the month of June. He will devote his time to writing and lecturing.

Dr. Shenfield has been economic director of the Confederation of British Industry, director of the International Institute for Economic Research and president of the Mont Pelerin Society. He has held visiting professorships at a number of U.S. colleges and universities, including the University of Chicago, Temple University, University of Dallas, University of San Diego, and Rockford College. This past year he was the Ludwig von Mises Distinguished Visiting Professor of Economics at Hillsdale College.

THE FREEMAN
IDEAS ON LIBERTY

Dimensions of Competition

by Joseph S. Fulda

Competition on the free and open market has long suffered criticism for its alleged imperfections. True market competition, it is averred, requires both buyers and sellers to have perfect knowledge of all alternatives. It likewise requires that buyers purchase with full knowledge of the composition, use, and possible weaknesses of the product being offered for sale. It requires further that convenience of purchase—location, wrapping, queues, delivery, etc.—be equalized, and that extraneous factors such as personal relationships between buyer and seller be discounted.

Obviously, the argument continues, these conditions are never met in practice. Advertising, salesmanship, packaging, and displays take the place of perfect knowledge of the market. Product information is all too scarce, unless required by law. Convenience of purchase and other factors unrelated to the product itself bias market decisions in countless ways. Who has not often heard arguments along these lines,[1] together with suggestions for "correcting" the market and "compensating" for its imperfections?

But the critics betray that they do not grasp the subtlety of competition on the market, its many aspects and dimensions. The rigid price-quality contest portrayed with the aid of computer models is more nearly a caricature than an idealization of the multidimensional workings of the market, for as we shall see, market processes are broad enough to encompass the many facets of exchange mentioned above.

Once stated, the nature of competition on the market can hardly be denied: *whatever* inclines a man to choose one product over another or to patronize one supplier over another is a dimension of competition. The man who seeks to influence the choices of his fellow man must thus be sensitive to *all* that may affect those choices. He must demonstrate an imaginative understanding of his neighbors' wants and, then, be ready, willing, and able to act on that understanding. Far from being a system of insensitivity as is so often charged, the market system uniquely rewards sensitivity to others in its broadest sense. Such sensitivity is marked along each of the many dimensions of competition and measured, in the aggregate, in profits or losses.

One such dimension, and the first hurdle facing a competitor, is the *quest for attention* from prospective buyers or sellers. As infants, we are unable to assimilate the stimulation which explodes all around us, and we attend only to that which is necessary, physically filtering out almost all the din of life. Later, as we mature, we learn to do the same on a more conscious level. It is doubtful whether we could long endure life without such filtering processes.

Knowledge of all possibilities of exchange and all market opportunities is thus not only impossible; it is undesirable. What is both helpful and possible is knowledge of many of those opportunities that, given the chance, we would act upon.

Since those presenting possibilities for exchange or other market opportunities seek partners to their transactions, it is hardly surprising that market institutions for the dissemination of information about market opportuni-

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ties have evolved so as to satisfy the demand for such matches. Advertising, salesmanship, packaging, and displays are among these market institutions. They serve to penetrate the barriers of inattention we have erected to screen out much from our experiences and surroundings that we do not deliberately seek.

Successful market penetration is both unusual, statistically speaking, and mutually beneficial when it occurs. It is also quite an individual matter. It is the individual's special tastes, interests, and inclinations which will determine which appeals for attention will be successful and which will not. That this is so is evidenced by the large investments in marketing research: potential buyers are sampled to find out what publications they read, what media they attend to, what shops they frequent, what other interests or characteristics correlate to purchase of a given product, and so on. All this aids the competitor's understanding of why and when people choose his product. This is crucial, for as with all dimensions of competition, success in the quest for attention depends on understanding what makes others choose and acting upon that understanding.

But this is only the first hurdle, the first step of the marketing process. We may know the jingle and avoid the product, compliment the manager on his fine display but turn away empty-handed. Having secured the attention of consumers, the competitor must now demonstrate the value of his product to them at several levels.

How Is the Product Valued?

At the first level, persuasive marketing will show that the need which the product satisfies is itself valuable to consumers. This is important since we have many competing needs to which we assign different values. Advertisements extolling education are at this level. At the second level, persuasive marketing will show that the product being offered to the public best satisfies (or best satisfies at a given price) some underlying need of consumers. Advertisements by farmers' associations praising the virtues of good, wholesome milk as well as promotions of schooling are at this level. Then, at a third level, the producer must demonstrate the attractiveness of his particular brand.

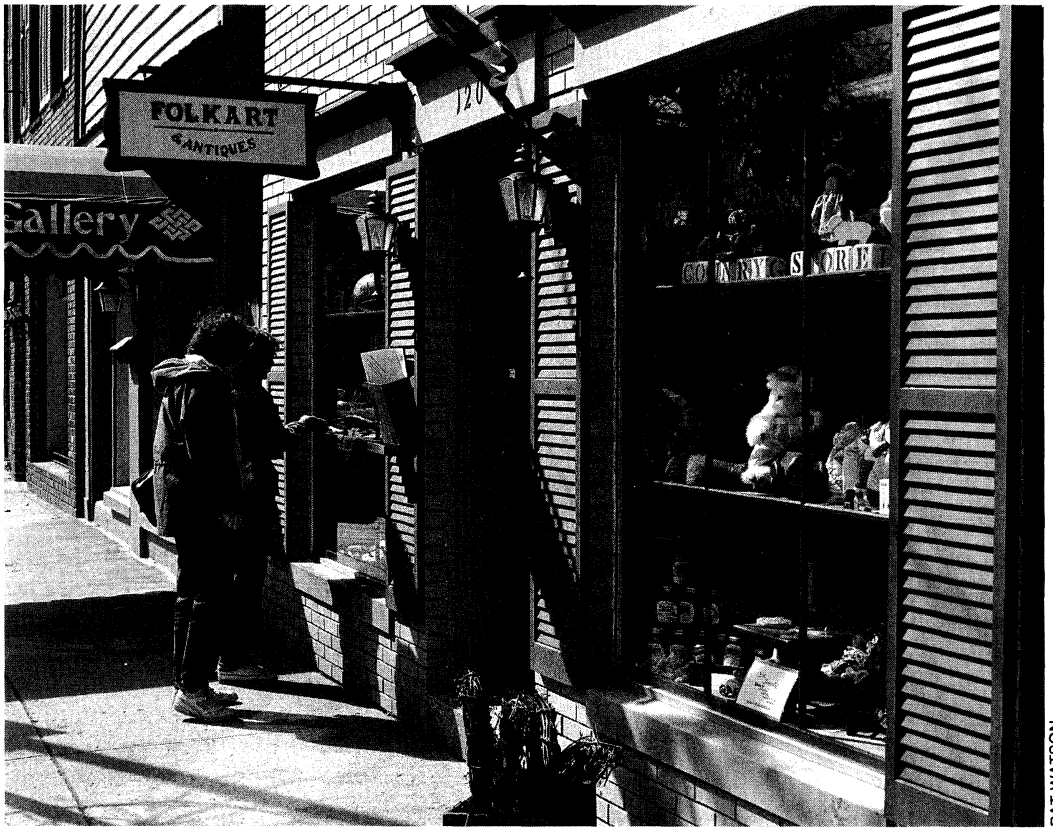
This classification of the levels of marketing activity brings into relief the corresponding levels of competition: among needs, among products, and among producers. (A fourth level of competition, among suppliers offering the same stock, will be treated later.)

Yet to some extent this division, like any other, remains arbitrary, with its boundaries somewhat vague. Thus, advertising for many products (e.g., mouthwash, breakfast cereal, and book clubs) typically crosses levels, while for other products (e.g., food and shelter) the first level may not even be at issue. For still other products, those on which the producer holds a patent or copyright, the third level is not at issue.

It is well to remember that classifying competitive activity by level and dimension is much like classifying any part of free human action: it may be useful as an expository device, but it is not to be a means to argue for differential legal treatment based on the chosen categories.

Thus far, our discussion of the persuasive component of marketing, unlike our earlier treatment of the quest for attention, has been unidirectional: sellers attempt to persuade buyers to exchange their money for the wares offered for sale. This is no accident, for while buyers, too, must often partake of the quest for attention, the remainder of the marketing process is nearly superfluous when the most marketable commodity, money, is offered in exchange. The first level of marketing activity is obviated by its very nature as a medium of exchange: its need lies in the need for any economic good whatsoever. In theory, the second and third levels of competition apply to money as much as to anything else. The contest between gold and silver typifies the former, while that between institutions offering promissory notes redeemable in specie or warehouse receipts typifies the latter. In practice, however, as the state has usurped the market in money, there is no real competition along the dimension of persuasive marketing among buyers.

That success in marketing is determined by the degree to which the competitor and his publicist understand the needs and wants of consumers, as consumers see them, does not mean that marketing of a product cannot seek to



PAT WATSON

"Location is a part of virtually every dimension of competition one can imagine: the quest for attention, persuasive marketing, information, price, convenience of purchase, pleasantness of purchase."

change the way people choose to allocate their resources, satisfy their needs, or decide among competing needs. That, on the contrary, is its *raison d'être*. It does mean, however, that effective marketing is based on understanding how people currently make their choices, including how, why, and under what conditions they might be influenced—they might choose—to alter their patterns of choice.

Another dimension of competition often ignored in models of "perfect" competition is *information*. Information, it should be recalled, is an economic good: it is both scarce and valued.[2] Information about a product will thus sometimes be available and sometimes not, depending on whether it is more profitable to procure and disseminate it or more profitable not to do so. This, in turn, depends on whether consumers value the information more than the resulting increment in price or not. We have treated the whole issue of product information comprehensively in an earlier study.[3]

In addition to information about product quality, information on pricing is also an aspect of competition. For example, computer-printed, itemized bills, electronic scales, and comprehensive price labeling each lowers the risk of overcharging consumers and their apprehension of being overcharged. Consumers may thus be inclined to prefer the supplier who provides this information over one who does not. As always, the amount of information provided is determined by the supply and demand schedules.

The information dimension is one along which buyers, too, must compete. When the seller accepts personal checks or purchases on the books, he exchanges his merchandise for something about the value of which his information is incomplete. In doing so, he bears a risk in return for a hoped-for profit from the policy (which includes gains from cash transactions by customers attracted by the policy) after subtracting defaults, penalties, and lost in-

terest. Buyers who provide more information are at an advantage in dealing with sellers who value that resource highly. Other buyers, transacting with sellers less concerned with this, gain from paying in a more convenient fashion or at a later date.

For all this, however, price and quality do remain the most important dimensions of competition, for they epitomize the process of exchange: value given for value. Yet price and quality, even aside from the various marketing and information dimensions, do not entirely exhibit the full richness of competition.

Convenience of purchase is a most important dimension of competition in an age of harried consumers, and *pleasantness of purchase* has been important in every age. Such factors as the location of the store, the length of its queues, the quality of its wrapping of products, the availability of delivery, the interior decorations, displays, music, the courtesy and helpfulness of sales personnel, and the like must all be taken into account by the competitor who would know success, since consumers allow them to affect their choices.

True, inconvenience of purchase could be figured in as *part* of the price and pleasantness of purchase as *part* of what is received, necessitating no change in the traditional view. The problem with such an approach, however tenable in theory, is that the monetary value that consumers place on such aspects of exchange as information, convenience of purchase, and pleasantness of purchase varies with the time of day, the consumers' mood, how tired they are, and a myriad other factors. The real world, that is, is in a constant state of flux, with the array of subjective values consumers hold being adjusted constantly. This reflects neither whimsicality nor irrationality on the part of the consumer, but rather rational and adaptive adjustment to external and internal changes.

These often elusive factors—hard to identify, harder to quantify, still harder to track as they change—may defy computer simulations of competition. But in an age of relative affluence, with small differences in price of lesser import, these factors become increasingly valued by consumers as the reader's own experiences measured against that of his grandparents will attest. Far from being extraneous factors that "bias" market decisions, convenience and pleasantness of purchase are integral parts of the exchanges of value for value that collectively comprise what is figuratively known as the marketplace.

Location

A final aspect of competition which deserves special mention is *location*. Location is a part of virtually every dimension of competition one can imagine: the quest for attention, persuasive marketing, information, price, convenience of purchase, pleasantness of purchase. Location also figures at many levels: which country, which province, which town, which district. At the higher levels, prevailing wage rates and business climate as determined by the presence or absence of particular government interventions are often the most important factors. At the lower levels, centrality of location, proximity of resources, availability of transportation, proximity or distance from competitors (depending on the business), etc. are often more important.

Location is also a factor within a shop, even within a product (think of a newspaper or magazine)! Indeed, it would be quite impossible for the casual observer to list all the dimensions or levels at which location figures, but even a cursory examination of one's own patterns of economic choice should persuade one of both its ubiquitousness and importance.

In sum, while competition occurs on many levels, along many dimensions, and with a fullness as rich as human choices can be, success is measured only in the aggregate, by profits or losses. The competitor will thus be told in no uncertain terms whether or not he is succeeding, and to what extent. He will never be told why. Just how he favorably or unfavorably affects the choices of those with whom he transacts is something to which he must be sensitive. That is the essence of competition on the market. □

1. See, for example, Gerson Antell, "Imperfect Competition," *Economics: Institutions and Analysis* (New York: Amsco, 1970), pp. 100-103.

2. Gary North, "Exploitation and Knowledge," *The Freeman* 32(January 1982):3-11.

3. Joseph S. Fulda, "Product Information on the Market," *The Freeman* 36(January 1986):29-33.

Touchstone of Truth

by Carl Helstrom

Frederic Bastiat wrote a book called *Economic Harmonies* because he thought that the basic principles of economics were intellectual guides that all men could follow to work together and improve their material and moral condition. All of Bastiat's writings are concerned with these simple axioms and their explication. In a preface to *Economic Harmonies* he wrote, "The central idea of this work, the harmony of men's interests, is a *simple* one. And is not simplicity the touchstone of truth?"

This is the beauty of the deductive maxims that men live by. They are elementary, yet they are "touchstones" for discerning truth from falsehood, right from wrong, good from bad, and correct from incorrect, within the realm of human action. Like the stone that tests the purity of gold and silver, a deductive theorem is a sure test to determine the value of an idea.

There are many such axioms. The Golden Rule, for example: Do unto others as you would have them do unto you. The Silver Rule of Immanuel Kant: Act only on that maxim through which you can at the same time will that it should become a universal law. Leonard Read's motto: No man-concocted restraints on the release of creative human energy. Most people have their own short credo or proverb that is really only a simple idea, but which, for them, constitutes the test for all their personal decisions.

Bastiat believed that adherence to the principles of economics would civilize men so that little coercion by governmental force would be needed to check the occurrence of ill-doing and to protect the integrity and property of right-acting people. For Bastiat, it was freely enterprising private citizens, and not government officials, who were the mainstay of civilization. Living by the simple truths of economics would promote moral behavior and increase the standard of wealth, without encumbrance by a patronizing bureaucracy, whether well-meaning or not.

Yet Frederic Bastiat's ultimate touchstone was his belief in freedom. Economic laws, or "laws of Providence" as he called them, were ancillary, for "If the laws of Providence are harmonious, they can be so only when they operate under conditions of freedom, for otherwise harmony is lacking. Therefore, when we perceive something inharmonious in the world, it cannot fail to correspond to some lack of freedom or justice. . . .we must not lose sight of the fact that the state always acts through the instrumentality of force. Both the services it renders us and those it makes us render in return are imposed upon us in the form of taxes."

A free society is a just society because men will live by the basic principles that govern human conduct in a world of scarcity—the principles of economics. Some will work because they have to eat, and because doing so will improve their material wealth. Others will labor because they believe that work is in keeping with higher ideals. But, all of them will work as harmoniously as possible because,

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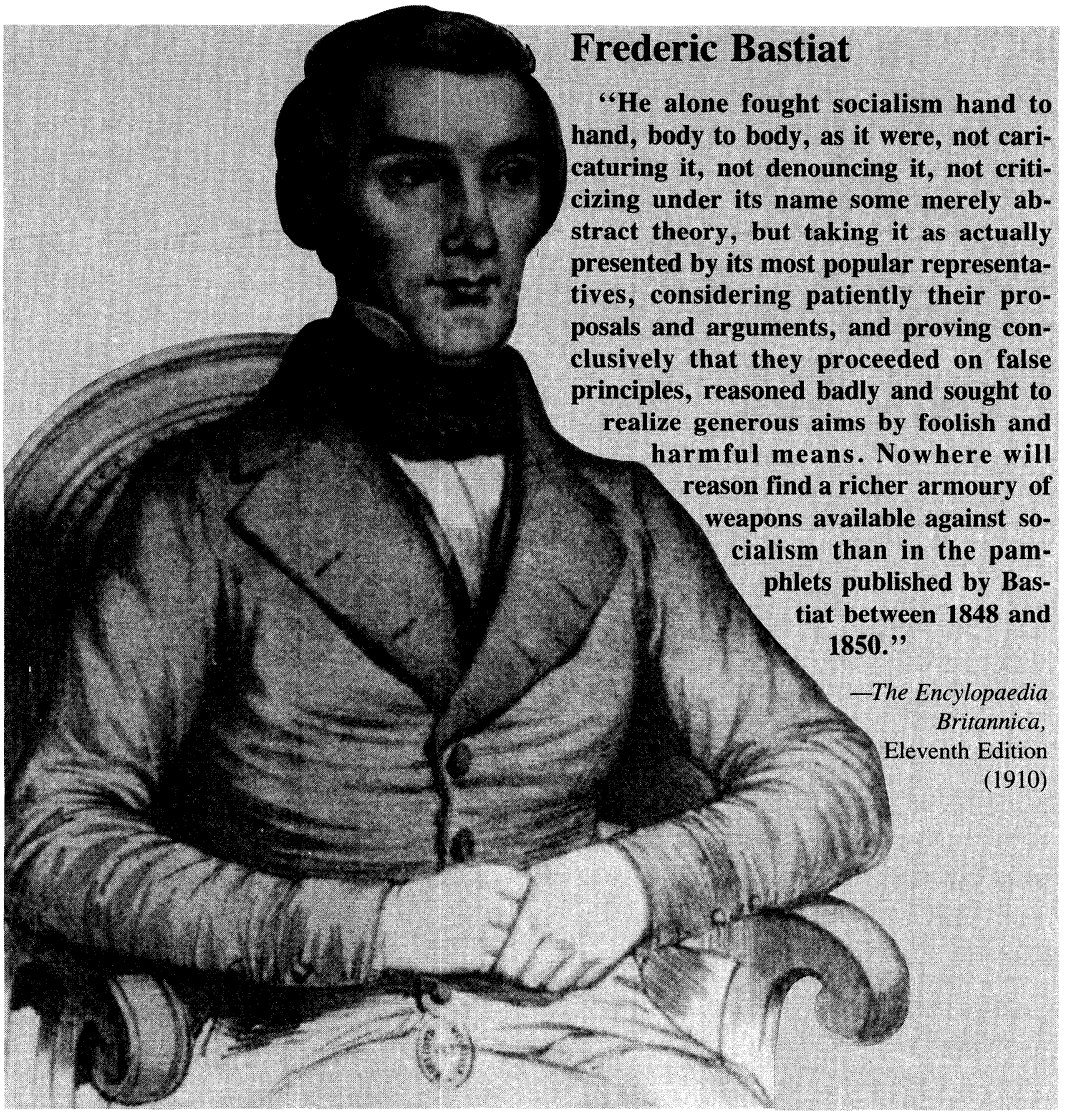

Frederic Bastiat

"He alone fought socialism hand to hand, body to body, as it were, not caricaturing it, not denouncing it, not criticizing under its name some merely abstract theory, but taking it as actually presented by its most popular representatives, considering patiently their proposals and arguments, and proving conclusively that they proceeded on false principles, reasoned badly and sought to realize generous aims by foolish and harmful means. Nowhere will reason find a richer armoury of weapons available against socialism than in the pamphlets published by Bastiat between 1848 and 1850."

—*The Encylopaedia Britannica,* Eleventh Edition (1910)

in a free society, people own what they earn and are secure in the knowledge that a force exists to protect their earnings. No one, not even this potential force, can take their property. This is the touchstone of a free person: Is it mine? Did I earn it? Only in a truly free society can you ask yourself these questions.

Like Frederic Bastiat, I fear the potentially harmful government more than the potentially harmful criminal. The government gone awry is shielded by the guise of officialdom, but the man who commits a crime is guilty before all society. A government has the ability to force circumstances upon me that are coercive and detrimental to my principles, but the criminal has at most only temporary, terroristic control over me. When I am reasonably sure that my life and property will be protected from attack or confiscation, and that I have recourse in the event of wrongdoing, then I will be content with the role of government.

I, too, have adopted the ideas of freedom in a free society, acting in accordance with economic principles. I try to make all my decisions according to the axioms I have learned in the study of freedom. Each day I marvel at the verity of these tests, whether I am analyzing economic, moral, or social issues, and I second the teachings of Bastiat. Simplicity, indeed, is the touchstone of truth. □

Mom's Monopoly, Part III

by Susan J. Osburn

After my son Sam's class moved into more complex topics in its economics unit, he came up with another question:

Sam: Mom, I'm going to ask you one last tricky question about economics. Can you explain about competition and antitrust laws? Why is the government opposed to trust?

Mom: It's not trust in the sense of relying on someone's faithfulness or honesty. A trust in this definition is like a conspiracy to control an industry and create a monopoly.

Sam: Oh! What's a monopoly?

Mom: First, you have to think about the free market system we learned about earlier. In a free market, buyers and sellers make lots of transactions. Prices, supply, and demand conditions interact and adjust themselves naturally according to the market expressions of people's changing wants, what the firms offer, and many other variables.

Some economists, however, think that for the free market system to work right, things have to stay perfectly balanced. They believe, in essence, that no firm should do better than its competitors and start to get bigger and more powerful. They want all firms to remain more or less equal in terms of their share of the market for their respective industries. This is called a *perfect competition model.*

But nothing is perfect in the real world, and when a firm becomes larger and stronger than the others in its industry, it's said to have a monopoly. There are various definitions of monopoly, but they all have to do with having a large share of the market.

Take hamburgers for an example. If Hallie's Hamburgers got really popular and the H.H. Company made a lot of money, maybe H.H. would buy McDonald's, Roy Rogers, Burger King, and Hardees. Then H.H. would be so big, it supposedly could control the price and supply of hamburgers to benefit just the H.H. Company. Since only little corner hamburger stands would now be competing with H.H., some economists believe that H.H. could wipe out these last competitors by lowering prices temporarily. After wiping out all competition, H.H. could then raise the price of hamburgers sky-high, limit the number available, pay hamburger cooks poorly, and even pay beef farmers poor prices.

That's the fearful picture of monopolies which gave rise to antitrust laws. Some people think a free market economy always turns into a nest of evil monopolies and has to be regulated by government. In fact, there's a big statue in Washington representing the idea of rampant markets being controlled by a benevolent government.

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Sam: A statue about *that*?

Mom: Yes. In front of the Federal Trade Commission building on Pennsylvania Avenue, there's a statue of two huge, muscular draft horses straining forward, and a giant nude man reining them in. The title of the statue might well be "Man Restraining Trade."

Sam: Whoa.

Mom: Exactly.

Sam: But back to Hallie's Hamburgers. If the H.H. Company got so mean and made their hamburgers so expensive, people would make their own hamburgers at home or switch to tunaburgers or hot dogs! Also, people would start to hate Hallie's and might boycott them.

Mom: You're right. The existence of substitutes is one of the arguments against the theory of *market failure,* which is what some people think even a partial monopoly represents. In almost every case there's at least one alternative to the product the monopolizing firm supplies. Sometimes it's an imported product.

Also, as you said, people may reduce their demand for the product because of price or even because of bad publicity, tending to make the firm behave itself. So the market process can bring monopolies back into line. In the long run, some other firm would arise to compete with any monopolizing firm. The only firms that get to hold on to a monopoly are those to which government gives special privileges such as licenses, tariffs, and other barriers to entry.

Sam: So have antitrust laws been a good thing?

Mom: They approach problems in the wrong way. Very often, antitrust suits have been brought by losing competitors, so you could say that the laws have been helping weak companies at the expense of efficient, well-run companies. Sometimes big firms may be better able to accomplish things than small separate companies. People can benefit from the efficiency of a big organization; its reduced costs can be passed on to consumers.

Sam: Then government should just leave trade alone.

Mom: Maybe. You can see the flaws in the perfect competition model on which the antitrust laws are based—unreal assumptions like all hamburgers tasting alike, all hamburgers selling at the same price, all buyers and sellers having perfect, complete knowledge of the market, and so on. Government shouldn't interfere just because a firm is successful.

There's a lot of pressure on politicians to eliminate even short-term negative consequences of market concentration, rather than waiting for competition to correct them. Some of these consequences are hard to accept, like restricted choice when one firm provides most of a product or service, or effects on a specialized labor force when there is basically only one employer. But the free-market argument is that the medicine society takes for these headaches makes it sicker in the long run, since government regulation also restricts choices and affects those specialized labor forces, and not always in the intended ways.

Anyone who's experienced in business knows that profit-seeking can lead unscrupulous people to very harmful acts. So society as a whole has to exert some control, but laws should be against misrepresentation or infringement of property rights, not against sheer size and success.

Maybe a true free-market system is something people will manage at a future higher level of mental and moral development. But at present many people even in America lack the educational background to operate effectively in a free market. But that's an argument in favor of educational improvement, not against free markets.

I guess I'm pretty much a free-market supporter. I do think the government is doing too much now, and particularly, doing the wrong things. It comes from understanding things wrongly. Depicting trade as a dumb animal is the wrong image for that FTC statue. The market is an expression of collective human intelligence.

Sam: Mom, I think you have a monopoly on this conversation.

Mom: But such a beneficial monopoly! Didn't you learn a lot?

Sam: We'll have to get the Federal Mom Commission to restrain you!

Mom: Then you can erect a statue of yourself holding onto my apron strings and call it Kid Restraining Lady.

Sam: Oh, *Mom.* □

The Crash of 1987: An Excuse for Government Intervention?

by John Semmens

On October 19, 1987, the U.S. stock market suffered its largest single-day loss in history. The 508-point drop in the Dow Jones Industrial Average was five times greater than the worst previous drop. In percentage terms, the 22 per cent decline exceeded the worst day of the infamous 1929 stock market crash.

If the market were free from government interference, a decline in stock prices wouldn't pose a serious threat to the economy. Of course, there would be need for some adjustment, as infeasible investments were liquidated and prices fluctuated to clear the market. But there would be no cause for great alarm.

Unfortunately, however, the market isn't free from government interference. In fact, government manipulation of the quantity of money and credit is a prime cause of speculative booms and busts in investment markets. The dramatic rise and fall of the stock market in 1987 surely was abetted by the Federal Reserve's actions to accelerate, then decelerate the growth in the money supply.

A critical danger at this point is that the stock market crash and the economic adjustments which must follow will serve as an excuse for further government intervention. As Robert Higgs points out in his recent book, *Crisis and Leviathan: Critical Episodes in the Growth of American Government* (Oxford University Press, 1987), crises, real or contrived, provide a convenient excuse for the expansion of government and the suppression of individual freedoms.

The crash of 1929 need not, by itself, have resulted in the Great Depression. However, the policies applied to a faltering economy by the Hoover Administration, Congress, and later, the Roosevelt Administration, stifled market adjustments and plunged the nation into a prolonged economic contraction.

President Hoover, acting under the mistaken idea that high prices mean prosperity, urged businesses not to adjust to economic changes. Firms were persuaded to refrain from lowering prices and wages and from liquidating malinvestments. Not surprisingly, widespread failure to adjust worsened an already bad situation.

While President Hoover was arguing against adjustment, government policies in the monetary, fiscal, trade, and regulatory arenas were sabotaging rational business and consumer responses to the changed environment signaled and precipitated by the stock market crash of 1929. On the monetary front, the Federal Reserve engaged in manipulations of the money supply that resulted in a 30 per cent decrease in monetary reserves over a three-year period. On the fiscal front, Congress enacted huge tax increases, while simultaneously appropriating funds for wasteful boondoggles like the Reconstruction Finance Corporation. Meanwhile, international trade was dealt a crushing blow by the Smoot-Hawley Tariff Act of 1930. Finally, a program of government harassment and med-

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dling with the marketing and employment practices of business was to become the mainstay of the new Roosevelt Administration through its alphabet soup of new Federal laws and agencies like the NRA (National Recovery Administration), the AAA (Agricultural Adjustment Act), and the NLRB (National Labor Relations Board).

What *Not* to Do

The crash of 1929 and the disastrous government policy responses over the ensuing years could serve as an example of what not to do in the wake of the crash of 1987. The deleterious effects of the policies chosen in the earlier era could be a useful warning of the hazards to be avoided. Tragically, it seems more likely that the errors of the past will be repeated. Government seems poised to duplicate the policies that led to so much hardship in the 1930s.

Monetary manipulation is, if anything, more entrenched as a policy now than it was in the 1920s and 1930s. In recent years, many devotees of this manipulation confidently asserted that Federal Reserve authorities would take action to assure rising stock prices through the election of 1988. The bursting of this bubble of optimism in October of 1987 has done little to diminish the manipulators' confidence that monetary authorities will prevent an economic recession from occurring prior to the 1988 election. The notion is that the Federal Reserve will create enough money to maintain purchasing power.

Life would indeed be easy if the mere creation of money could increase purchasing power. The harsher reality is that only production can create real purchasing power. The creation of money only achieves the transfer of purchasing power from the productive to those favored by access to the easy credit provided by the monetary authorities. The productive elements of the economy are penalized by having some of the real value they have produced, in effect, stolen from them via exchange for inflated money. The financial capacity to regenerate the next round of production is reduced by this process. The growing awareness of the expropriation effected by money creation diverts erstwhile productive endeavors to actions aimed at minimizing the damage of inflation. The result is lower real output and lower real purchasing power.

Inflating the money supply and depreciating the dollar's purchasing power is a government scam that has been perpetrated for decades. It enables the government to avoid paying back the full value of the funds it borrowed from those who bought its bonds. The expectation that an acceleration of this scam will produce prosperity is a dangerous fantasy. The fear that the desperate circumstances facing the U.S. government will prompt runaway inflation has already sparked a "run" on the dollar in the international marketplace. The likelihood that other governments will retaliate with inflations of their own (thus repeating the rounds of competitive currency devaluations of the 1930s) threatens to spread the ill effects of monetary expansion into a worldwide epidemic.

Coping with the declining real purchasing power engineered by inflationary monetary policy will not be the only problem confronting businesses and consumers. Governments at Federal, state, and local levels are bent on intensifying the fiscal burden on all taxpayers. Despite the widespread awareness of the huge amounts of waste in government budgets (the Grace Commission spotted $140 billion per year at the Federal level, alone), there are no plans for significant cuts in spending. Neither the highly publicized compromise plan announced by Congressional and Administration conferees in December, nor the Gramm-Rudman sequestration process, invoke any actual net reductions in Federal spending. Under either approach, Federal expenditures for the current year (or any other year covered by either approach) still will continue to grow. The highly touted "cuts" consist solely of a slowing in the rate of increase in government spending. In fact, all of the "cuts" in spending during the Reagan years have amounted to nothing more than a slight slowing in the rate of growth in Federal outlays. Even at this slowed pace, Federal spending has still grown faster than the rates of inflation and population growth combined.

While still continuing to increase spending on blatantly wasteful programs, politicians are furiously concocting schemes to expropriate

more resources via tax hikes. The search for a so-called "painless" tax, of course, is an exercise in futility. There are no taxes that have no negative impact on economic activity. Whatever is taxed will be discouraged.

The quaint notion that corporations can be made to bear more of the burden, thus sparing hard-pressed individuals, is the most alluring delusion of the tax-raisers. To survive, corporations must cover all costs—including taxes—from available cash flow. Increased taxes must be covered by higher prices to consumers, reductions in other operating costs (for example, wages), or smaller profits. Real human beings will bear the brunt no matter how the costs are distributed.

To many proponents of higher corporate taxes, the prospect of smaller corporate profits appears the most acceptable outcome. Some tax bills even attempt specifically to target corporate profits and to bar the sharing of the burden with consumers or employees. Even if the full burden of the tax could be nominally restricted to corporate profits (a doubtful undertaking, at best), a tax that is effected via a reduction in corporate profits will tend to reduce stock prices. A further lowering of stock prices would aggravate the problems caused by the initial crash—the emergency used to support the call for government action in the first place. Lower stock prices will mean businesses will have a harder time acquiring capital. Making it harder for businesses to acquire capital will not help to relieve recessionary conditions.

The refusal to accept real reductions in government waste, and the insistence on increased taxes, will place even greater burdens on a weakened private sector. Thus, while scarce resources will continue to pour into redundant military bases, agricultural surpluses, money-losing rail passenger service, public project cost-overruns, welfare fraud, and other "essential" expenditures, funds for private-sector business purposes or consumer purchases will be severely curtailed. The ramifications of this chain of events are further business contraction, lower output, more unemployment, lower tax collections, more filings for unemployment compensation and welfare. If the private, productive sector must bear the total burden of an economic decline, the economy could be sent into a downward spiral that would be difficult to reverse under government's determination to tax and spend.

At the same time that government is prepared to deal the private sector a one-two punch composed of monetary inflation and fiscal profligacy, it is also proposing to preserve and protect American industry by imposing punitive trade barriers on imports and by offering to formalize government/business/labor partnerships through industrial policy initiatives.

Avoiding the Blunders of the Past

Trade barriers played a critical role in deepening and prolonging the Great Depression of the 1930s. Apprised of this, you would think current policy-makers in government would steer clear of so obvious a blunder. Unhappily, it seems that repetition of the blunder cannot be ruled out. The assertion of trade barrier advocates is that this time is different. When the Smoot-Hawley tariff was enacted in 1930, the U.S. had a trade surplus. Now, the U.S. has a trade deficit. However, the whole trade surplus versus deficit issue is an arbitrary concoction that has little relevance to actual business dealings.

Trade takes place because each party to a transaction willingly exchanges something he has for something he wants. Therefore, trade is always in "balance." Adding up and comparing the flows of merchandise, while excluding the flows of cash or financial assets, as the conventional balance-of-trade calculation does, is an exercise in self-delusion. There is no reason to expect the flow of merchandise ever to be in balance, much less for it to balance in any fiscal year. Nor is it the case that a surplus is "favorable" and a deficit "unfavorable." Attempts to engineer a reduction in imports in order to produce a more favorable balance of trade are more likely to impede efficiencies and lead to unfavorable results for all trading partners.

Regardless of how self-destructive trade barriers are, any U.S. action to block imports is almost certain to generate so-called retaliation. That is, if the U.S. government acts to prevent U.S. citizens from buying cheaper foreign

goods, foreign nations will retaliate by barring their citizens from buying cheaper U.S. goods. The most efficient producers in each nation will be the ones hurt the most. Harming the most efficient firms in world commerce will raise the cost of living for the people of each affected nation. This will reduce real purchasing power and promote economic hardship.

Even if other nations are sensible enough not to retaliate, the U.S. still will be harmed by erecting import barriers. Barring U.S. businesses and consumers from acquiring goods from the most efficient producers in the world will obstruct efficiency and prosperity in America. U.S. businesses will be forced to substitute second-best, more costly inputs in the production process. The final output will be of lower quality and higher cost. This will further diminish the competitiveness of U.S. firms in the international marketplace. Consumers of American-made products will be forced to pay more in order to get less. While it is true that government-mandated trade barriers will help some firms and individuals, the net impact for the economy, as a whole, will be negative.

There are some advocates of trade legislation who aver that barriers are not intended as a policy, but, rather, as a threat. Once foreigners become convinced that the U.S. is bent on a punitive course, it is argued, they will take steps to remove some of the trade barriers they have in place against American exports. Such a "doomsday" sort of threat must surely denote a state of confused desperation in U.S. government policy-making circles.

Sound economic analysis has long demonstrated that trade barriers are damaging to the economies of the nations that impose them. If two centuries of evidence and logic have failed to prevent or remove existing trade barriers, we can hardly be sanguine about the chances for removing barriers by first threatening to increase them. It will be of little comfort to the average American to know that others probably will suffer as much, or more, from the mutual stifling of international trade that is likely to result.

The most irresponsible position on trade barriers is demonstrated by those who court partisan political advantage by supporting legislation that they hope will be killed by someone else. Import barriers are proposed by those posturing as friends of American industry and labor. The proposers of import barriers portray themselves as persons willing to do something about the trade problem. Though they know that the import barrier "cure" is pure poison, the plan is to denounce anyone who would dare to be more responsible by opposing this remedy. Thus, the political support of key special interests can be curried while the disastrous bill is defeated by "do-nothing" Congressional colleagues or vetoed by an "insensitive" President. In the unhappy event that no one is courageous enough or potent enough to block trade barrier legislation, then no one will be to blame because everyone went along. Disasters enacted by consensus are politically safer and, therefore, preferred by officeholders whose highest priority is re-election.

As bad as trade barriers are, their potential for mischief and abuse could easily be exceeded by "public-private partnerships"—collaboration among business, government, and labor in making decisions on production, hiring, marketing, distribution, and the like—established through so-called "industrial policy" initiatives. The force which disciplines the private sector and ensures its attention to customer service and efficiency is competition in the marketplace. It is the fear that rival producers will do a better, more cost-effective job of serving customers that stimulates private sector firms to improved performance. In contrast, the monopolistic, noncompetitive, tax-supported public sector is legendary for its inefficiency and indifference to customer service.

A "Partnership" with Government

"Helping" U.S. businesses by joining them in partnership with government would be akin to expecting a sprinter to run a better race as a member of a chain gang. The federal government, remember, is the operation with at least $140 billion per year in waste. The federal government loses money on virtually every undertaking it attempts. The federal government is unable to dispense with anachronisms like the Tea-Tasting Board. The federal government

pays $600 each to buy hammers for the Pentagon. Partnership with these guys is going to make American industry more competitive and vigorous?

Enmeshing the private sector with government industrial policy holds no prospect for salutary consequences. Firms are apt to become bogged-down in red tape or in schemes to fix prices or tap into the public treasury. Attention to cost is likely to atrophy. Competition will be undermined. Customers will fade in importance relative to bureaucrats and legislators. Real output cannot help but suffer.

By this time, readers will have noted that the current menu of policies for dealing with the difficulties facing the U.S. economy bears an unpleasant resemblance to policies adopted during the Great Depression of the 1930s. We know better; but lust for power and the desire to use government to obtain resources that cannot be earned seem to be more potent motivators than knowledge and reason.

When this country plunged into the Great Depression, the dead-weight burden of excessive government was only a fraction of what it is today. In order to get elected, Franklin Roosevelt at least had to promise to rein in the spending taking place under the Hoover Administration. Today, not even a pretense of fiscal responsibility is considered necessary by those seeking elective office. In this respect, the future looks exceedingly grim.

On the positive side, the U.S. economy is wealthier than it was in 1929. There is more of a cushion between our current standard of living and the rock-bottom that was hit by many people in the 1930s. This gives us a little more margin for error. At the same time, though, the public sector and the private interests that feed off public funds are much more voracious than 50 years ago. The higher level of wealth enjoyed today could mean that the drop to rock-bottom will be steeper and deeper this time around.

If we are to avoid this steeper and deeper depression, we will need to pursue policies diametrically opposed to those currently being touted. Instead of monetary manipulation and inflation, we need a dollar that preserves its value and purchasing power. Instead of more government spending and taxing, we need substantial reductions in government expenditures and we need real tax cuts. Instead of a suicidal program of trade barriers, we need to remove all impediments to the efficiency gains of specialization and comparative advantage that naturally flow from free trade. Instead of a stuporous partnership between public and private sectors, we need less interference by government in the workings of a competitive marketplace.

Knowing what needs to be done and getting it done through the political process are two different things. Whether the nation avoids repeating the policy mistakes of the past remains to be seen. □

Preserving the Joy of Giving

by Kenneth A. Bisson

The bicentennial of the U.S. Constitution served as a wonderful opportunity to explore the ideals of limited representative government with my oldest son, Adrian, who is in the third grade. He had enjoyed participating in a local writing competition called "Young Authors," so I suggested we work together on a book. We drafted a children's book to convey some of the principles of the Constitution to an elementary reader.

Our plot involved the adventures of some young Americans developing the rules for their friendship club as their parents gathered in Philadelphia in the summer of 1787. This was an exercise in explaining individual rights and how they need to be protected from an unrestrained democracy. I realized how committed he was to those ideas when he came home from school quite irritated one December day.

It is customary in our local school to have a Christmas gift exchange among classmates. Those choosing to participate buy a $1.50 gift and, upon providing this for a classmate, receive a gift purchased by another student.

As a way of expanding the joys of holiday giving, Adrian's teacher proposed the following to the class: They could make a charitable gift of the money they would otherwise spend on a classmate's gift and instead bring a wrapped discarded toy from home for a "junk exchange." She also proposed that each student make a contract with his or her parents to earn the $1.50. The class accepted these proposals, which seemed splendid to me.

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The joy of giving depends on its voluntary nature. Webster's dictionary defines *gift* as, "something voluntarily transferred by one person to another without compensation." For gifts to exist, property rights must be recognized. One must personally own the thing being transferred for it to qualify as a gift. Thus, the students' decision to earn the donated money was important.

The choice of the recipient must remain with the giver. He may delegate that choice (as with general contributions to United Way), but a transfer of property to an unintended recipient is not a gift. If you are delivering cash collected for United Way and a masked gunman "persuades" you to deliver it instead to him, you are not giving him a gift. Even if he uses the funds to help his needy family, you would not experience the joy of giving from such a coerced transfer.

The harmony of voluntary giving becomes disrupted when the conditions of the transfer are coerced. It was the method of choosing the recipient that bothered Adrian. The class suggested the local Humane Shelter and African Famine Relief as potential recipients. Discussion began and the advantages and disadvantages of the alternatives were raised. Some wondered whether their "hard-earned" money would actually bring food to the hungry Africans. Apparently they had heard of diversions of some previous famine aid. Adrian was certain he wanted his gift to go to the Humane Shelter.

The teacher decided that the choice should be made by a vote of the class. The choices

offered were: 1) all the money would go to the Humane Shelter, 2) all the money would go to African Famine Relief, or 3) the money would be divided equally between these two causes. Choice three received the most votes and the class was told that half of their donation would go to each cause.

Adrian remembered from our book that "majority rule" is an inappropriate way to make many decisions. He felt it wasn't right for others to determine the destination of his gift. This experience had a happy ending. Upon Adrian's suggestion, the teacher permitted each contributor to give his or her donation to either cause in the proportion each student preferred. The potential conflict that was produced by requiring a collective decision was removed. The harmony fostered by allowing individual choice was restored to the holiday giving.

Adrian also became motivated to complete a writing assignment which was due that week. He used the idea from one chapter of our book to write his story. With his permission, I have reproduced it here for you.

Martha's Blueberries

A. BISSON

By Adrian Bisson

One day a long time ago there was a group of children who decided to have a club. Their names were Tom, Martha, Bill, John, Rebecca, and Jim. Soon it was time for a club meeting. So they all met by the clubhouse. Just as they were about to start the meeting they realized that Martha wasn't there. Martha had been in the woods picking blueberries. When she realized that she was late for the meeting she ran as fast as she could to the clubhouse. When she got there Tom saw the blueberries and said, "Why don't we vote to see if we should eat Martha's blueberries." Everyone except Martha smiled and nodded. So Tom said, "Everybody who wants to eat all of Martha's blueberries raise your hand." Everybody raised their hand except Martha. Suddenly Martha cried, "It isn't fair to take away what I worked so hard to pick." After thinking about it for a while the others agreed and they finished their meeting.

From this experience the children learned that things should not always be decided by majority rule. □

Beyond Hayek: A Critique of Central Planning

by Tibor R. Machan

In his critique of central planning, for its inability and inefficiency in allocating society's resources, F. A. Hayek summarizes his reasons for preferring the price system to the planned economy:

> The most significant fact about this [price] system is the economy of knowledge with which it operates, or how little the individual participants need to know in order to be able to take the right action. In abbreviated form, by a kind of symbol, only the most essential information is passed on and passed on only to those concerned. It is more than a metaphor to describe the price system as a kind of machinery for registering change, or a system of telecommunications which enables individual producers to watch merely the movements of a few pointers, as an engineer might watch the hands of a few dials, in order to adjust their activities to changes of which they may never know more than is reflected in the price movement.[1]

For this reason Hayek holds that central planners could never allocate resources efficiently or coordinate society's activities for the purposes which they wish to achieve. They would lack the price system, which carries the information throughout the economy that contains the record of individual market choices.

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Hayek holds that the belief in the efficacy of planning betrays an unwarranted trust in human reason. When he finds reason inadequate to the task of centrally planning an economy, he appears to have in mind a particular conception of reason—Cartesian deliberative reasoning. But this is not what is meant when we refer to the reasoning faculty of individual human beings. It is by this reasoning faculty that individuals identify their needs, wants, values, and constraints within their individual contexts. And in Hayek's criticism of central planning, or rather in his grounds for that criticism, he seems to agree that the faculty of reason is a means by which we identify our situations and guide ourselves within them. He seems also to be aware of this conception of reason when he refers to John Locke's characterization. "By reason . . . I do not think is meant . . . here that faculty of the understanding which forms trains of thought and deduces proofs, but certain definite principles of action from which spring all virtues and whatever is necessary for the proper molding of morals."[2]

Despite his awareness of this idea of reason, and despite the implicit recognition of its vital necessity for the efficient operation of an economic order, Hayek tends to demean reason in general and praises a kind of spontaneity that suggests the absence of rational choice in human behavior. He is committed to the operations of human action as a kind of irreducible factor in the economic life of a society, rather

than a product of reasoning. And this seems to be because Hayek equates reasoning with deliberation or design. The two, however, are not the same.

Deliberation vs. Simple Intentional Conduct

Deliberation is a kind of reasoning that compares to double checking in calculation or accounting. This is the kind of reasoning stressed by Hobbes and Descartes, a sort of monitoring activity, overseeing what one has done before.

There can be reasoned conduct that is not deliberative. Simple intentional conduct, which comprises the bulk of what we do, is not accompanied by double checking or monitoring. For example, as we enter a room at night we reach to turn on the light and once this is accomplished we move on to do numerous other things, all rather "spontaneously," i.e., non-deliberatively, with no explicit design. Yet this kind of conduct is neither nonrational nor arational. It is the kind of reasoning that we need to learn in childhood, the kind that we'd better learn very well, to the point of its being almost automatic, lest we waste too much time on the ordinary details of our lives and cannot reserve the more deliberative thinking for more complex tasks such as analyzing markets and designing rocket boosters.

Still, in the final analysis, the discovery of the principles an individual must adhere to and the goals an individual should pursue requires use of the individual's faculty of non-deliberative reason. It is just this sort of reasoning faculty that collective bodies of human beings do not as such possess. And when it comes to satisfying our needs, wants, desires, goals, purposes, and so on, we must rely on our reasoning faculty to obtain the particular information that we can gain only from the point of view of our own individual situations.

Despite the fact that Hayek is famous for stressing the importance of this kind of knowledge and the need to rely on it for purposes of obtaining an efficient economic system, he seems not to wish to credit human reason for being able to obtain it. The reason for this seems to be his equation between deliberative and non-deliberative reasoning.[3]

But something must be added to the Hayekian thesis because by itself it is not a sufficient criticism of central planning. As E. J. Mishan observes, the Hayekian critique

> would be more compelling . . . if the declared aim of [e.g.] a Communist regime were that of simulating the free market in order to produce much the same assortment of goods. We should bear in mind, however, that the economic objectives of a Communist government include that of deliberately reducing the amounts of consumer goods which would have been produced in a market economy so as to release resources for a more rapid build-up of basic industries.[4]

Some have argued that Hayek can reply that he does not simply criticize the economic inefficiency of central planning as a matter of the satisfaction of individual demands but as a matter of any kind of successful planning. In other words, efficiently coordinated planning itself requires the knowledge that only the price system, backed by the judgments of particular circumstances carried out by individuals, can supply. And by its nature this can be done only by individuals who are aware of their own circumstances, including their budget constraints, the extent of their wealth, and so forth.

But all of this still leaves it open whether we ought to worry at all about fulfilling individual wants, needs, and so forth. Why not just plan by reference to the goals of the state?

Another objection to the type of rebuttal offered by Mishan is that even a fully effective dictatorial system requires knowledge of production costs and this is best communicated via a price system. But here again lurks the assumption that what is crucial is economic efficiency. Suppose that a system values discipline and this can be fostered through regimentation of work. Such a system, which may well have been the essence of the Egypt of the pyramids, would command production and not be concerned with cost. Cost of production is only important where producers have the right and inclination to demand payment for services. In convents and monasteries no such demand exists, and in a totalitarian system none is permitted.

In the last analysis, then, we must add to

what Hayek teaches us something his criticism actually presupposes. This is that an economy *ought to be fashioned* to function (e.g., by way of a "constitution of liberty," one Hayek himself supports) so as to satisfy individual preferences. But this is a controversial idea in political economy and philosophy. The scientism of neo-classical economics and the value-free stance of even the Austrian School tilts forcefully against it.

Yet, if ethical individualism is true, nothing is taken from the scientific character of economics. Assume that each person has the moral responsibility to be individually successful in life. Then each must have a determinate sphere of sovereignty or authority for action. That implies a system of private property. It also implies freedom of trade, since any regimentation would violate the moral sovereignty of the individual. If so, then collective planning is not only inefficient but morally reprehensible. It implies the undermining of the moral nature of individual human beings.

But why should this conflict with science? Once the system is granted from a moral point of view, the economist can ask, what can we expect of people within such a system? What can we predict of the institutions of that system, given that people ought to and very often will act prudently and economize? Virtually all the postulates of "economic man," barring its imperialist extrapolation to a dominant posture in non-market spheres, will remain intact.

Some of the reasons for the present position may be summarized here, based on points discussed elsewhere.[5]

1. The capacity for rationality must be exercised by *individuals*. There is no such thing as a collective cerebral cortex or collective reason. The initiation of the process of thought is necessarily an individual human project. Collectivism is a mistake in part because no collective capacities exist apart from those which individuals create through pooling their individual faculties and other resources.

2. The truths which rationality can unearth for individuals are mostly about individuals and their individual traits, needs, opportunities, goals, and fortunes. And it is in terms of such information that the moral guidelines by which individuals should conduct themselves must be identified.

Here is where the Hayekian point about central state planning is brought home very clearly. We should add that any centrally planned system, even one conceived along democratic lines, aims largely to avoid the "anarchy" of the market and thus would construe efficiency along lines very different from mainstream economics.[6]

Preserving the Sovereignty of the Individual

The present account, in which individual purposes are deemed worthy of shielding from state intrusion *on moral grounds,* rejects central planning on grounds that such planning substitutes for individual sovereignty the will of the leader, leading group, or some politically active majority. Thus it supports the Hayek/Mises thesis on grounds that the understanding of efficiency along neo-classical economic lines is largely sound, since it is indeed individuals whose purposes ought to be served by economic systems, even when it is admitted that some of these purposes are objectionable now and then. But since it is individuals who ought to be setting their own goals and be held responsible for their having set the goals they chose, an economic system ought to adjust to this, and not try to adjust to some end-state conceived independently of the sovereign choices of individuals.

The individual's plans are very different in kind from any sort of collective plan in part because individuals may face different sets of challenges in life and so, of course, may have different goals. (This, by the way, precludes the possibility of their *uniformity,* which is what collective planners must assume so as to be able to ignore the facts pertaining to individuals as individuals.)

3. By collectivist strictures, as Marx puts it, "The human essence is the true collectivity of man."[7] Accordingly, rational collective economic planning does not consider individual traits, goals, and talents as crucial. Only our common traits matter to collectivists. And if this were a warranted stance, it could be consistent with the aim to centrally plan society's

economic affairs. This is because any ranking of preferences, wants, wishes—i.e., the allocation of resources—would be a matter of the unilateral decision of the central planning board, somewhat as this occurs in a monastery or kibbutz. Where conformity to the planner's ranking of preferences can be secured—either by choice or via force—the price system (which communicates divergent needs, wants, wishes, goals, etc.) is not essential.

But the assumption of such global or society-wide collectivism is a drastic and devastating metaphysical and moral oversight. Individuality is essential to being human precisely because every person is a rational being—a concrete biological individual with the capacity for original, creative rationality. Both one's concrete biological individuality and one's capacity for rationality are necessary to being human. So when one considers the nature of a human polity—as Marx and Plato did—one must treat as vital what any person must be, namely, a human *individual*.[8]

Persons are not able to escape their humanity—they are *human* individuals. Treating them as isolated monads or atoms—an idea promptly seized upon and denounced by socialists—has to be rejected. And with this we must reject the impossibility of any degree of political-economic collective "planning," the notion from Hayek that gives anarchists so much intellectual fuel. With respect to their equality as moral agents, individuals must be understood to share certain features which require a human social order to be constituted in certain ways—that is, it must rest on natural, individual, human rights to life, liberty, and property, and be protected in an integrated, principled manner.

Based on a clear understanding of our human nature, certain natural rights may be identified and a political order *can* be planned or designed. But the collective planning must be confined to the genuine concerns of the public at large, that is, to everyone's few identical concerns.

Within this context, The Constitution of the United States may be seen as a suitable general plan or design. What is different in such a plan from those spoken of in connection with socialist planning is this: Socialists model their planning on the business firm or social club; they treat all property and persons as if they had a common purpose and were available for use in the realization of this purpose. Socialist planning, then, is regimentation, not bona fide economic planning, on the model of the business firm!

But a constitution only spells out certain prohibitions and procedural rules, not goals. It does not specify the goals for society but makes goal-seeking possible to all members of society. If we can consider a constitution as a design, its purpose is to serve the innumerably varied purposes of individuals with equal respect for everyone's task of pursuing the best possible purpose that he or she has come to identify. And the rules in terms of which a constitution aims for this purpose are to make possible for everyone to practically follow through on his or her moral task. □

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1. F. A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), pp. 86-7.

2. John Locke, *Essays on the Law of Nature*, ed. W. von Leyden (Oxford: The Clarendon Press, 1954), p. 111.

3. Of course, the requirement of this individual faculty of reason for an efficient economic system does not deny the utility of general principles of human conduct. Yet even the identification of such general principles, not to mention the decision to apply them in particular circumstances, is necessarily the task of individuals, albeit possibly the outcome of the work of many of them over time.

4. E. J. Mishan, "Fact, Faith & Myth, Changing Concepts of the Free Market," *Encounter* (November 1986), p. 66.

5. See Tibor R. Machan, *Human Rights and Human Liberties* (Nelson-Hall, 1975), "The Classical Egoist Defense of Capitalism," in T. R. Machan, ed., *The Main Debate: Communism versus Capitalism* (Random House, 1987), and "A Reconsideration of Natural Rights Theory," *American Philosophical Quarterly*, Vol. 19 (January 1979), and *The Moral Philosophy of Individual Liberty* (Stockholm, Sweden: AB Timbro, 1987).

6. See Paul Craig Roberts and Matthew Stephenson, *Marx's Theory of Exchange, Alienation and Crisis* (Hoover Press, 1973). The authors show that what Marxist central planners are most critical of in the market economy is the presence of free exchange, which then creates uncontrolled demand. In place of this Marx advocates a command economy, not because it will be more efficient, in the neo-classical economic sense, but because it will lead to the production of what *ought* to be produced.

7. Karl Marx, *Selected Writings*, ed. D. McLellan (Oxford University Press, 1977), p. 126.

8. For a clear exposition of this point, see David L. Norton, *Personal Destinies* (Princeton: Princeton University Press, 1976).

Fractional versus 100% Reserve Banking

by Morris J. Markovitz

There has been a long-standing conflict among Austrian economists about the nature of the best or most "freedom-consistent" banking system for a true laissez-faire society. The issue is important because the two viewpoints are not merely differences of degree. Both sides invoke the same fundamental moral and economic principles, yet each comes out in opposition to the other.

How can this be? This article contends that it can't be—that there's a logical flaw at the base of both arguments, a very minor but logically critical one—and that actually both sides are right when the issue is restated in the proper terms.

To show this, let us first summarize both sides of the debate. The 100-percenters say that in a free society, force is outlawed, a statement both sides can endorse. Next, since fraud is a form of (implicit) force, it too must be banned. Since a fractional reserve system promises to pay specie in amounts greater than what actually exist, that promise is a fraud. Therefore, the 100-percenters contend, a fractional reserve banking system has no place in a free society.

The fractional reserve advocates, who disagree with the 100-percenters, also base their arguments on free market principles. In a free market, they say, anyone can do what he wants as long as he doesn't use force against others. This includes banks. If a bank issues notes that aren't 100 per cent backed by specie, by what right do we stop them? They aren't forcing people to accept the notes.

Notes of the less-well-backed banks will circulate at a bigger discount than notes that are more well backed. A promise to pay the bearer doesn't have to be backed 100 per cent at all times. Otherwise, a promissory note from an individual who had no gold, but who expected to be earning a gold paycheck in future weeks, would be just as guilty of fraud. That's obviously not the case, and yet, the fractional reserve advocates conclude, there is no difference in principle between an individual's unbacked promissory note and a bank's fractionally backed note.

In summary, the 100-percenters have shown that the fractional reservers are advocating fraud. The fractional reservers have shown that the 100-percenters advocate force (by legally prohibiting the freedom to issue partially backed notes). This is why the debate, while never really hitting the headlines, is such a serious one: from each side's view, the other side is guilty of a severe moral transgression.

Periodically the debate flares up, and each side reasserts its logically self-consistent argument. Neither side, however, refutes the other's argument. Finally, everyone throws up his hands in exasperation and the debate peters out once again. Each side tries to be cordial to the other, but, because such moral issues are involved, the debate has to be an obstacle to genuine goodwill between the two factions.

Having stated the problem, we now come to

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the resolution. The apparent contradiction arises out of a subtle fallacy, named "intellectual package dealing" by Ayn Rand. Besides accepting the same explicit moral principles, each side, unfortunately, has also accepted the same implicit "package deal."

A "package deal" is the inappropriate "packaging" of two or more different concepts under a single label. It can be used consciously to mislead, or unwittingly, causing confusion. In this case, two completely separate things are meant by the term "banking system," each of which, combined with the same set of free market principles, will support only one side of the debate while refuting the other. Once we separate the two different concepts, there will be no difference of opinion left.

The package deal arises subtly because, in today's mixed economy, institutions called "banks" actually perform more than one function. They are supposed to be safe havens for capital. They are also loan brokers. Throughout most of modern history, "banks" have performed both functions, and in fact both functions have been melded into differing aspects of a single, complicated banking system.

That's probably why the error occurs so naturally and automatically. The two functions have become inextricable from each other in a government-mandated system that tries to have its cake and eat it: to provide 100-per cent guaranteed safety of bank deposits, while employing a fractional reserve method.

The Warehouse Function

One of a "bank's" functions is to be a safe warehouse. This is obviously a valuable function, and in a free market people who desired this service would pay for it. Its analogy in today's world would be a safe-deposit box: a protected stronghold for the storage of valuables, for which the user pays. In a free market, those availing themselves of this "banking" service would deposit their specie in a "bank" where it would be held under lock and key. They would receive, essentially, a warehouse receipt or claim check for it, and in some fashion the service would have to be paid for. The claim checks would then circulate as fully backed money substitutes. This is the image in the minds of the 100-percenters, who nevertheless fear that temptation would lead the "banks" to cheat.

Laws against fraud, however, would prevent this, as applied to this particular banking function. Even in today's market, banks are not allowed to break into private safe-deposit boxes and "borrow" their contents without the owners' consent. The 100-percenters are correct that the same ought to be true in the ideal laissez-faire economy, and for this aspect of banking, the fractional reservers should be able to agree completely. Clearly, stealing from safe deposit boxes is force.

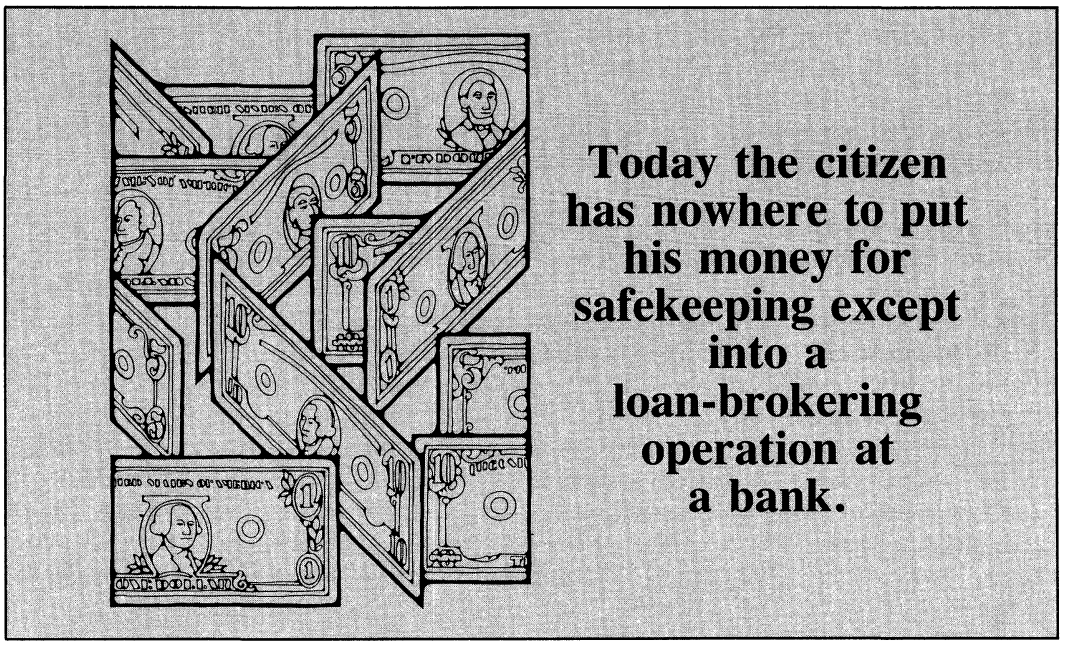
Banking today, however, also entails another completely separate function. Banks act as loan brokers, accepting deposits for which they pay interest instead of getting paid for safe storage. They then lend out these deposits at higher rates and profit from the difference, as well as (and more so) from the creating of deposits via the fractional reserve system.

Today the citizen has no real choice between the two functions. He has nowhere to put his money for safekeeping except into a loan-brokering operation at a bank. (He could put green cash into a safe deposit box, but the inflation engendered by the very system he's trying to avoid precludes this as a sensible option.)

As the fractional reservers point out, there's nothing wrong with loan-brokering. What's wrong is forcing people to deposit into a loan-brokering scheme by forbidding the alternative, while simultaneously falsely advertising the loan-broker outfit as a safe warehouse. That's what today's banking system does and both sides would agree that it's wrong.

In a free market, both functions ought to be permissible, but clearly defined and separated. This doesn't mean government regulations, but rather legal definitions that distinguish the two concepts, clarify their differences, and serve as the basis for legal redress if and when a loan-brokering operation fraudulently advertises itself as something else, and someone sues.

The 100-percenters want a clean, stable, no-questions-about-it currency that serves the role of money. This they will have without prohibiting the fractional reservers' loan-brokering "bankers." The notes of these loan brokers, in practice, probably will not even circulate as



money, but as interest-bearing notes, similar to commercial paper today. If they were clearly identified as a loan-broker's fractionally backed (promissory) notes, then no one would accept them unless the notes paid interest appropriate to the financial risk they entailed. (Remember, it is only the existence of legal tender laws that allow Gresham's Law to work. If people aren't *forced* to accept bad money, then *good* money will drive *bad* money out.)

The 100-percenters can confidently acquiesce in allowing the existence of fractional "loan-brokering" by "banks," knowing that without legal tender laws, these notes will have to show their true colors in the marketplace, as the equivalent of commercial "promissory notes," and never would achieve the status of money. Since a genuine need for safe storage does exist, there will also be someone, somewhere, who issues 100 per cent backed notes for the convenience of his customers, and those pieces of paper will circulate as money, by the natural workings of the market.

In practice, it may well turn out to be most efficient to house these two functions under one roof, but *never to blend them into one "system."* Just as we have money-market versus bond "switch funds" today, a single institution could offer both services. A cautious citizen might avail himself of only the warehouse facility, where his gold deposits would be physically segregated, and he would pay for this service. If he wanted to lend to industry, he could have some or all of his gold transferred to the other side of the "bank" and accept the risk in return for the interest.

In sum, if we:

a) separate the concept of "banking" into its two distinct functions (warehousing and loan-brokering);

b) recognize this distinction in law, as part of the general body of law on fraud; and

c) eliminate legal tender laws,

the result will be a money and credit system that satisfies all the requirements of both camps. □

Making Every Drop Count: The Case for Water Markets

by Don Leal

Nearly every summer, cities and farming regions in the West experience water shortages. Such shortages may seem inevitable in the arid West, but, in fact, much of our precious Western water is actually wasted.

One reason for such waste is that it is difficult for people to trade water. Enormous amounts of water have been made available through government-financed dams like Hoover and Glen Canyon, but the people who received the right to that water many years ago don't have the freedom to sell it to others today. Fast-growing municipalities may be willing to pay more than the water is worth to the current users—but such trades are usually impossible to arrange.

Legal restrictions also discourage owners of water rights from saving water and protecting the environment. If the owner decides to save some of the water for fish by leaving it in the stream, the owner usually forfeits the right to that water. Given Americans' growing interest in sportfishing and environmental amenities, such a restriction is out of step with the times.

The purpose of this article is to show how water markets can solve water shortage problems and enhance environmental quality, and to suggest what institutional changes are necessary to make this happen.

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The History of Water Trading

During the last half of the nineteenth century, the early California gold miners initiated a system of property rights to water that allowed buying and selling. The system, known as the "prior appropriation" doctrine, allowed miners to establish rights to divert specific quantities of water based on who diverted it first. This "first in time, first in right" ownership, which was upheld by the mining districts and later by state courts, provided the basis for water trading. For a time, the West had in place a system which fostered efficient water use.

For most of the twentieth century, however, courts and state legislatures have been chipping away at the foundations of the prior appropriation doctrine. Critics of private ownership contended that water was a "necessity of life," too precious to be controlled by the market and thus in need of state administration to guide its usage. The water rights that evolved from the quasi-legal setting of the early mining districts were replaced by permits to use state-owned water, with decisions on water use ultimately determined by state water officials.

At the same time, growing interest in instream uses from navigation to recreation began to collide with demands to divert water for agricultural and mining purposes. A general belief that only government could meet these demands for instream water meant that private ownership was limited to diverted water, not instream water.

Furthermore, in response to the claim that private owners could never support the huge capital investments needed to meet water demands in the developing West, the federal government became a major factor in providing water. Starting in 1902, the Bureau of Reclamation began to build massive delivery and storage systems "to make the desert bloom like a rose," supplying water to farmers at a fraction of its total cost. Today, much of the water used in agriculture is effectively owned by the federal government. Irrigators may derive benefits from water, but they are not at liberty to transfer their water to other than agricultural uses. Water must stay where it is, and other users who want water have to come up with expensive alternatives, such as building new dams and reservoirs.

The Problem That Water Markets Would Solve

For many years, engineering marvels like Hoover Dam and Glen Canyon Dam seemed to make water scarcity a thing of the past. The federal government had the deep pockets, the Bureau of Reclamation had the bureaucratic savvy, and the Western farmers had the political clout to push for more such projects. This "iron triangle" encouraged overinvestment in water storage and delivery, wasteful water practices, overdevelopment of marginal agricultural land, and destructive environmental practices.

During the Carter Administration, this triangle began to break down. In spite of massive water projects such as the Central Arizona Project and the Garrison Diversion Project, water shortages continue to exist, and building new dams is no longer automatic. The best sites have disappeared, and environmentalists, opposed to the destruction caused by dams, have more clout. With Congress facing large budget deficits, congressmen can't appropriate money for dams and large reclamation projects as easily as in the past. Out of this breakdown is emerging renewed interest in the water marketing system devised by frontier entrepreneurs.

If water rights were fully owned—that is, clearly defined, enforced, and transferable—owners could be expected to act very differently. A true water owner faces the full cost of using water, including its value in other uses. To use water himself, an owner must forgo other offers. If these alternative uses are more valuable, the owner has the incentive to reallocate the scarce commodity to its higher-valued use by selling it.

Consider the potential gains to many groups from water trading. If a city is willing to pay more for drinking water than the water is worth for irrigating crops, farmers gain by selling or leasing it to the city. The city obtains a new water source without large capital outlays. Taxpayers gain by not having to finance water projects, and citizens generally gain by not having dams and canals which harm the environment. It is from these gains that political coalitions favoring water marketing are being built.

Such a coalition is emerging in support of water trading between farmers in California's San Joaquin Valley and southern California's burgeoning metropolitan population. The Metropolitan Water District (MWD) of Southern California is forecasting significant supply shortages for the 1990s unless new sources can be acquired. Simultaneously, three hundred miles north, the San Joaquin Valley is experiencing a steady deterioration of soil quality from years of salt build-up and high concentrations of selenium in its agricultural drainage water. In fact, it became evident in 1985 that drainage water into Kesterson Wildlife Reservoir was causing bass, catfish, and carp to die and newly hatched waterbirds to display crippling deformities. As a result, water to the San Joaquin's Westlands Water District was shut off temporarily and now millions of dollars are being spent to correct the problem caused by cheap agricultural water.

A water trade between the MWD and the Westlands Water District could, according to the Environmental Defense Fund senior economist Zach Willey, "take us a long way toward defusing the water crisis." Since MWD will have to pay as much as $500 per acre-foot to divert river water into new reservoirs, it surely could strike a bargain with farmers. Farmers could make a profit—even if they invested in water-saving drip irrigation costing $175 per

acre-foot. The environment would be better off, too, since less high-salt water would drain into lands such as the Kesterson Refuge.

This trade may never happen unless the Bureau of Reclamation, which supplies the water to the Westlands Water District and controls its use, allows farmers to sell the water. In the past, the Bureau typically would not allow such a transfer of water it controls, but new coalitions are changing the political climate for the Bureau, putting it under increasing pressure to allow water trading.

While the trade between the MWD and the San Joaquin farmers offers one of the better examples of gains from water trading, others are waiting in the wings. A recent report from the Water Efficiency Working Group of the Western Governors' Association suggested that many potential transfers "probably are thwarted simply because the procedures for making the transfers and the Bureau's willingness to approve them are not clear."

Enhancing the Environment Through Instream Flows

In addition to encouraging the efficient use of diverted water, water trades have untapped potential for enhancing the environment. In recent years, Americans have increased their demand for water-related recreation and for environmental amenities. Both are greatly influenced by the quantity and quality of streamwater, neither of which is now represented in market transactions.

Currently, the job of assuring adequate water in streams and rivers belongs to state agencies. Understandably, they are reluctant to reserve instream flows when such reservations collide with existing diversion rights, as they may in streams where all or nearly all the water has been allocated.

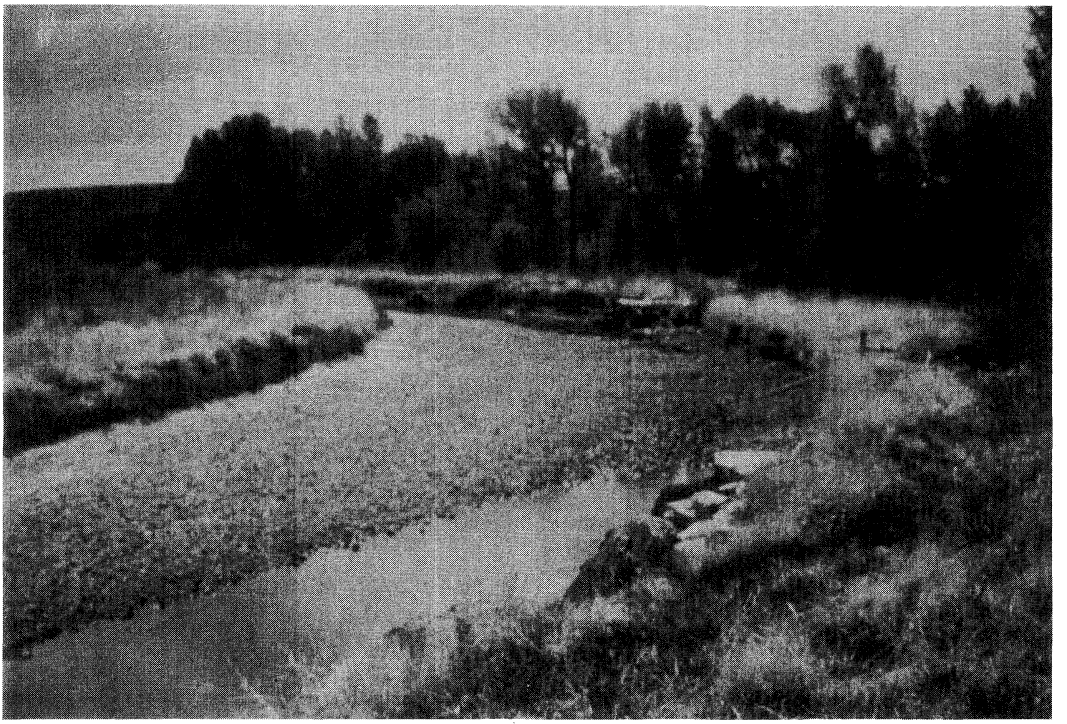
An excellent alternative would be for private owners to purchase water rights and keep the water in the stream. Unfortunately, legal obstacles abound. To obtain a right to water, the owner must put it to what the courts or administrative boards consider a "beneficial use." And in most states, courts have looked upon claims as non-beneficial if there is no diversion. For example, in *California Trout, Inc.* v. *State Water Resources Control Board,* a 1979 case, a private non-profit corporation was denied an appropriation of water to protect fish habitat. The argument was that there was no evidence that California Trout, Inc. was diverting or physically controlling the water it wanted.

If legal obstacles to private ownership of instream flows were removed, conservation groups such as Trout Unlimited and the Nature Conservancy could make great strides in protecting fish and wildlife. On the Gunnison River in Colorado, for example, Pittsburgh and Midway Coal Company has agreed to donate a large water right to the Nature Conservancy to maintain instream flow, and has promised not to divert additional water from the Gunnison Gorge, even though it has the right to do so. The Conservancy will have to turn this water over to the state to keep it in the river. (Currently, the only way that the water can be kept instream is for the state to have control of it.)

A far better solution would be for the Conservancy to hold the right. The Conservancy serves only one interest, protecting habitat, while the state must serve many interests. During dry periods the state will be under pressure from farmers and ranchers to allow diversion of water it holds.

If ownership of instream water were allowed, private owners could also respond to temporary demands. During a recent drought, resort owners on the Guadalupe River in Texas got together and purchased water releases from an upstream authority, temporarily increasing instream flows from 20 to 100 cubic feet per second. This example indicates that market alternatives do sometimes exist, but they are risky. Owners of downstream rights on the Guadalupe may still be legally entitled to the water that has been added to the river.

Conflict between diversion and instream use was illustrated on the Ruby River in southwestern Montana during a dry period in the spring of 1987. Excessive irrigation reduced the water flow so drastically that over 500 fish died. The fish kill could have been prevented had the flow of the river been increased by 150 cubic feet per second. The state's Department of Natural Resources and Conservation eventually did this—but not soon enough to save the



The Ruby River after draw down.

fish. Furthermore, this modest action by the state created conflicts with downstream diverters, who claimed they had the right to the water.

A market for instream flow rights could have solved the problem. Indeed, while the fish were dying, farmers had water standing in nearby fields! If an organization such as Trout Unlimited could have purchased or rented some of the water of marginal value, the farmers probably would have been happy to supply it.

Ownership of instream rights could enhance recreational opportunities and habitat protection in another way as well. The Yellowstone River Valley south of Livingston, Montana, offers some of the finest opportunities in the world to flyfish on spring-fed creeks. Yet it is the private, not the public, sector which is providing these opportunities to the public at between $30 and $35 per person per day. Since the creeks begin and end on private property, owners can collect fees for fishing. They have strong incentives to ensure quality fishing by protecting the stream banks from cattle grazing and by avoiding overfishing. If instream water could be owned, other opportunities for quality fishing would probably develop because owners would be able to capture benefits from maintaining and improving habitats.

In England and Scotland, private ownership of fishing rights has long been accepted. With rising demand for fishing in England, "there are few landowners . . . who can afford to ignore the commercial aspect of the sporting rights which they own," writes Douglas Clarke in his book *The Landowner*. Privately managed fisheries have proliferated in Britain in recent years, placing many kinds of fishing within easy reach, both geographically and financially. To protect their investment, British owners hire private fish and game managers and invest in capital improvements to the streams.

What Future for Water Marketing?

Some states are beginning to take positive steps to encourage voluntary water transfers. State legislators in New York, Colorado, Utah,

and California have recently made it legal to transfer surface water rights temporarily from one person or agency to another without giving up future rights. The California legislature has also taken steps to encourage voluntary water conservation by allowing those who conserve to sell the water they save. Previously, those who saved water lost it. Steps like these will further efforts to conserve water and move it to higher-valued uses.

Another promising development is the endorsement of water transfers by the Western Governors' Association. In 1986 the Association identified voluntary water transfers as a productive way to increase efficient use of water and formed a working group to figure out how to encourage water transfers. The resulting report urges the governors to work with the Interior Department (which houses the Bureau of Reclamation) to develop legislation facilitating trades of Bureau-supplied water.

In addition, the Bureau of Reclamation recently announced that it is planning to scale down its operations by, among other things, emphasizing "water conservation" and "finding opportunities to turn over projects to local agencies." Such a move may mean that the Bureau will more readily allow local irrigation districts to conduct water transfers.

Enter, the Public Trust Doctrine

But at the very moment that the idea of full, transferable private ownership of water is emerging, a new threat to water markets has arisen. It is called the public trust doctrine.

Originally, this legal theory was used to assure that waterways would be navigable, but this changed dramatically with a 1983 court case in California, *National Audubon Society* v. *Superior Court of Alpine County*. The state of California was forced to limit diversion of water from Mono Lake—a major source of Los Angeles drinking water. The court decided that the public has a "trust" relationship to the environment and wildlife of Mono Lake, and must protect them.

This concept was codified in Montana law in 1985 following two Montana court decisions. Montana law now specifies that 17,000 miles of streambeds be open to the public. Since owners of the land adjacent to these streams no longer have any right to control access, they may well decide to discourage access by allowing the water quality and fish habitat to deteriorate.

But the implication of the public trust doctrine is much greater than this. As it creeps slowly into legal decisions throughout the West, it has the potential to undermine the private right to use water. If the public holds all water in trust, the state may have a right or even obligation to interfere with existing water diversion and water trades. The doctrine also would serve to dampen motivation for private parties to improve instream water since any improvements can prompt the state to claim it in the name of the public trust.

Conclusion

In sum, the prior appropriation doctrine provides the basis for trading water in the West, but legal and bureaucratic restrictions are stifling trades. At the same time, the public trust doctrine threatens to erode what progress has been made.

To make water marketing viable, the Bureau of Reclamation must take steps to encourage exchange, and private ownership of water rights must be extended to instream water. Fortunately, the outlook for developing political coalitions to bring about such reforms is promising because water markets offer something for nearly everyone: They can eliminate water shortages, reduce environmental degradation, and reduce governmental spending, too. The recent announcement changing the focus of the Bureau of Reclamation's efforts, the work by the Environmental Defense Fund supporting water marketing, recent legislative changes in the West, and reports from the Western Governors' Association are indicating that support for water marketing means "going with the flow." □

Celebrating the Constitution—and Village Fires

by Richard R. Mayer

The really interesting thing about a fire isn't watching the fire, or even the fire engines and firemen who are fighting the fire; rather, what's really interesting is to watch the people who are watching it all.

So with our recent celebration of the Constitution. What seemed most interesting was what we as spectators made of its anniversary.

The same was true of other celebrations during the past several years, dealing with the Declaration of Independence and the Statue of Liberty. They were mostly pageantry.

In the case of the Declaration it was hard to detect any serious contemplation of the document or its theses. The Statue's celebration was even more bizarre. It was capped by fireworks and plush yachts in New York harbor and, ironically, the almost simultaneous enactment of a new immigration law requiring not only proof of worth by those who would heed the spirit of the beckoning Lady but, even more so, proof by those of us already born here.

And so with our recent celebration of the Constitution; it seemed mostly irrelevant, even contradictory.

Three emphases were notable: the Preamble, the Amendments, and the Pledge of Allegiance to the flag. The first two seem peripheral, the last, unrelated. What's wrong with emphasizing the Preamble, Bill of Rights, and Pledge of Allegiance? Let's look at each more closely.

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The Preamble

The Preamble is just that, a preface. It is not the Constitution itself but rather a setting forth of the reasons for the law which follows. Thus the Preamble speaks of a more perfect union, justice, tranquility, defense, general welfare, and liberty. These were the purposes of the Constitution, but they were not the law itself. The Constitution proper was the nuts and bolts of how officials are selected, who has what powers, and the like. It is political engineering designed to promote the Preamble's purposes. Whether such goals would be gained by this structure was a matter of conjecture on the part of the founders. Yet it must be clear that their product was machinery, not goals. It was the means; whereas the Preamble was the ends.

And here we enter the treacherous thicket of means and ends. The ends sought in the Preamble could not be guaranteed. The best that could be hoped for was to establish a favorable climate. To concentrate on ends is always dangerous; it places us in the position of justifying any means to accomplish them. To emphasize the goals (justice, general welfare, and so on) is to make what followed immaterial—any means would be acceptable. No, it was the means, the constitutional machinery itself, which were agreed upon. The Preamble merely set forth the reason or logic, the guiding star, for that which followed.

This is not unlike other agreements or con-

tracts. A father and son may covenant that in order to win at sports, get a diploma, and stand on his own feet, the lad will practice faithfully, attend classes, and get a job after school. What is actually agreed to here is practicing, going to school, and earning money. The recital of winning, diploma, and self-sufficiency are merely reasons for the agreement, its preamble.

To allow these introductory reasons to become the primary concern is to permit any means to their end. Thus the boy could justify fouling his opponent, cheating on exams, and robbing banks, since these would advance him toward the goals of victory, a diploma and wealth, which are sought.

So it is with the Constitution's Preamble. Emphasizing the Preamble has allowed us to erroneously think that any means toward general welfare, tranquility, liberty, and so on are justified. But these, in fact, are goals. The only thing really justified by the Constitution is the means set forth in the actual document which follows the Preamble.

This is the danger in emphasizing the Preamble. Yet that is what we saw so much of in the recent celebration. Commemorative postage stamps quoted the Preamble; citizen responses declared that the Constitution's value was that it "guarantees my success" or "freedom" and the like—all of which is not the actual Constitution, but rather its purpose. This is dangerous thinking.

Amendments

A second emphasis was on the Amendments to the Constitution, particularly the Bill of Rights.

Obviously amendments are not a part of the Constitution proper. An amendment, by definition, is something which alters the original. Yet here is where, again, great emphasis was placed.

Probably this is because, as with the Preamble, the Amendments deal largely with goals or ends, rather than means. Most of the Amendments (at least the exciting ones) deal with various freedoms and rights, prohibition of alcohol, equality, and the like. These are what we want, rather than how we plan to get there. That is why they are so much more of interest than is the Constitution proper with its nuts and bolts machinery of the journey.

Again, this is dangerous, for such a view tends to unleash any means to the acquisition of these ends. And this is what the founders feared and intended to proscribe—the unbridled power toward any end. Again we hear the trumpet call (as in the Preamble) of "We the People!" and let's not pay too much attention to the rules (the Constitution itself) lest it frustrate the accomplishment, by any means, of our chosen ends.

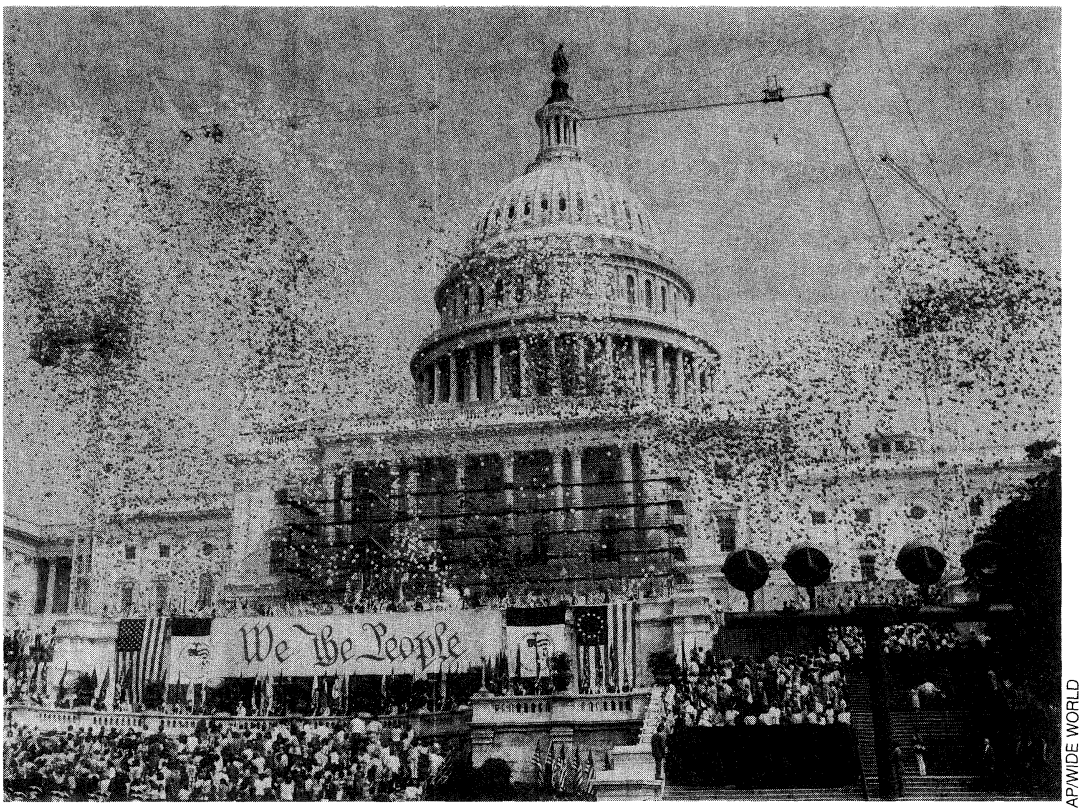
The Pledge of Allegiance

Finally, a third emphasis so noticeable was the Pledge of Allegiance to the flag—a strange gesture in celebrating the Constitution, both in regards of time and intent. The Pledge came only much later in the evolution of our political ceremonies, and its spirit seems unrelated, even incompatible, to the Constitution.

Any pledge of allegiance has the sense of subservience or loyalty of a people to their state or its symbols. Such expressions have little relevance to the machinery of government, to the Constitution we were purporting to honor—indeed, a Constitution which was designed to limit state power. The Pledge sounds forth a people's obligation to their country, rather than the Constitution's restraints on that country's power over its people. Particularly troublesome was the specter of massed children, under duress of their mentors in compulsory state schools, rotely reciting allegiance to a political talisman which suggests a fealty at odds with the true spirit of the Constitution.

Now if the Preamble, Bill of Rights, and Pledge of Allegiance seem peripheral or unrelated to the Constitution, how would a true celebration of that noble document appear? Probably quite boring! Yet that was the problem with which we were faced.

To be honest in our celebration, a more appropriate 200th anniversary probably should have addressed the mechanics of the Federal form of government, separation of powers, constraints on the state, the actual enumeration of the powers granted to the various branches, tests for office, and the like. If we did get to the



AP/WIDE WORLD

More than 100,000 red, white, and blue balloons were released over the Capitol during the September 16, 1987, celebration of the Bicentennial of the U.S. Constitution.

Amendments we should not have ignored such critical ones as the ninth and tenth.

Legal Fiction

This was not to be. Perhaps it is because the Constitution has become what historians call a legal fiction. Like the Crown for many Englishmen, the Constitution has become for us something which, though important as a symbol and rallying cry, is little more than that. Hence we emphasized the Preamble which states its purpose and tends to justify any means to these ends, the Amendments which changed it to satisfy more recently desired ends to be acquired through the state's coercive powers, and a Pledge of Allegiance which generally regiments everyone into a mental state of going along with society's agenda. It all seemed a non-celebration of the Constitution—or, perhaps better, a celebration of the non-Constitution.

A local newspaper was illustrative in this regard. Of the six page special section devoted to the forthcoming celebration, a mere quarter page was given to a not altogether cogent paraphrasing of the Constitution itself, and this on the back page at that. The other 5¾ pages were devoted to the Preamble, the Amendments (two full pages), some rather shallow commentary, trivia type questions, editorial expressions of how certain current goals could be achieved by further flexing or amending the document, and sundry notices of planned pledges of allegiance.

As we did indeed see, the celebration culminated in a mass Pledge of Allegiance led by the President and former Chief Justice, all of which seemed more sideshow than main event—the celebration of our organic law.

And so, more interesting than studying the Constitution itself was observing our public celebration of it; so reminiscent to running down the street at the sound of sirens, to watch the people who are watching the fire. □

Liberty in Great Britain: The Present and the Future

by Nick Elliott

In Great Britain, liberty is making a strong run in the competition of ideas. Margaret Thatcher's Conservative government has given a public face to a body of ideas which preceded, and will outlast, her administration.

The most notable changes since 1979, when Thatcher was first elected, have been in economic policy. "Privatization" is the popular term for three classes of policy: the sale of state-owned industries to private shareholders, the contracting out of state services to private firms, and deregulation of private markets.

Stock offerings in state industries and public utilities are now a regular event. The public offering of British Telecom shares in 1982 pioneered the policy, and quelled popular suspicions by yielding easy profits for the small investor. Public offerings since then have included British Gas, British Airports Authorities, Rolls Royce, British Airways, and Jaguar. Those lined up for dispatch at the moment include water authorities, electricity, and coal mines. So far, the policy has entailed a transfer of asset ownership from state to private. The public utilities, however, remain statutory monopolies, with rival producers being excluded.

Debates are raging in economics journals over whether privatization has brought improvements in efficiency. One problem is that the government is concerned with other things besides efficiency. Privatization is often used as a means of filling Treasury coffers, and the asset value of any newly privatized company would tend to be reduced if competition were permitted. It also seems prudent to make changes gradually, to evade the organized hostility of public sector unions and other interest groups, so that private sector monopoly may appear to be a necessary step on the road to free capitalism.

The second method of privatization involves competitive bidding by suppliers for the provision of public sector services such as refuse collection and hospital cleaning. This policy has saved local authorities much money, but as John Blundell of the Institute for Humane Studies has contended, money saved may not be returned to citizens in the form of lower local taxes.[1] The policy is not an unambiguous improvement. Despite these reservations, the policy has at least been discussed and—most importantly—accepted by the public, as an advance of market forces.

Most praise should go to the third policy of privatization, the deregulation of private markets. Two examples are worthy of note. The introduction of private sector competition into local passenger transport has worked quite well, and has become an accepted part of life for many people.

The other example is the "Big Bang" deregulation of financial services, which allowed for the combination of the roles of broker and jobber, and abolished the requirement of fixed commissions for jobbers. This has ensured that London will remain a major center of financial activity, and employment will continue to move into the financial sector. Significantly,

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many more workers in financial services have a share stake in the continued prosperity of capitalism. In addition, the market remains relatively unregulated, characterized by continual change. In this environment, workers are far less likely to endorse welfare state attitudes.

Regrettably, the deregulation of the financial sector has been tempered by two policies. The first of these, in 1985, made "insider dealing" a criminal offense; the law was rushed through Parliament in an attempt to conciliate Members of Parliament ruffled by trading scandals. The second, a greatly ominous piece of legislation, established a "self-regulatory" organization, the Securities and Investments Board. Effectively this has established a system of licensing for investment firms, and the probable danger is that established operators will use these new powers to exclude competitive beginners.

But these policies have not been nearly as significant as the shift in popular ideas that has taken place since 1979. Partly as cause, and partly in consequence of Thatcherite economic policy, there has been a favorable movement in popular opinion. The unspoken presuppositions which define the limits of debate have moved distinctly in favor of the market. Competition and efficiency are now regarded by most people as necessary and desirable; people no longer believe that the welfare state is faultless; all politicians now clamor to be defined as "libertarian."

Why the Ascent?

It is instructive to look at the reasons for this shift in thinking and for the economic policies outlined above. Circumstances and an independent change of ideas are responsible.

Margaret Thatcher was elected in 1979 following a decade in which socialism demonstrably failed. Support for Thatcher was a rejection of what had gone before. The 1970s were a period of turmoil when the inability of government to control events was exposed in sharpest detail. These years were characterized by a lack of realism in which consequences seemed to belong to the distant future. Trade unions were at their strongest because government courted them. Union leaders were regularly welcomed at Downing Street for discussions on economic planning. At the same time, with a Labour government, unions could afford to be militant. In 1979, however, people remembered strikes and electrical power cuts, and voted against them.

Prime Minister Thatcher

Until 1976, monetary policy was highly inflationary. Prices rose from the late 1960s onwards, peaking at a 33 per cent annual rate in the first quarter of 1975. The culmination was the balance of payments crisis in 1976. To avoid a plummeting pound, the government applied to the International Monetary Fund for a loan; this was popularly perceived as a national disgrace. From that time onwards, printing money was discarded as a policy solution. From 1976 to 1979 the Labour government maintained tight monetary control. Profligate spending was no longer a viable policy. This fact was recognized, most significantly, by Prime Minister James Callaghan speaking at the Labour Party conference of 1976:

> We used to think that you could just spend your way out of a recession and increase employment by cutting taxes and boosting government spending. I tell you, in all candor, that that option no longer exists; and that insofar as it ever did exist, it only worked by

injecting bigger doses of inflation into the economy followed by higher levels of unemployment as the next step. That is the history of the last twenty years.

Public choice theory, at its simplest, gives gloomy predictions about what voters will vote for: the most attractive party will be the one offering the most handouts. Fortunately for Britain, voters in 1979 did not decide based on their immediate pecuniary self-interest. They recognized that, while their long-term interests would be advanced by the Conservatives, austerity would have to be endured in the short run.

These were the events which brought to prominence a revived system of classical liberal ideas. The intellectual tradition of liberalism was kept afloat in the interwar years by a handful of intellectuals like Edwin Cannan, Ludwig von Mises, and Wilhelm Röpke. The genesis of a new intellectual movement began after the Second World War. Under the auspices of the Mont Pelerin Society, politicians met with academic proponents of the free economy to compare notes. At the very time when policy, more than ever before, was conceived amidst the misapprehensions of state planning, libertarian ideas were reviving in academia. Milton Friedman began his notable efforts to bring the market to the masses with the publication of *Capitalism and Freedom* in 1962. At the same time, F. A. Hayek was working on an analysis of the economy of knowledge in markets and, reciprocally, a destruction of the conceptual foundations of central planning. Both these economists have been a major inspiration to the British Conservative government.

In the same period, the Institute of Economic Affairs was founded in Britain to promote the work of liberal economists. IEA papers have covered every imaginable topic of economics, they have been read by politicians, and are an acceptable component of university courses. In some cases, such as passenger transport and exchange controls, a direct influence on policy has been evident, but their more important function has been to alter the general limits of academic debate within which policy is conceived.

Public choice theory has been fundamentally important in explaining why societies fall prey to creeping collectivism, and why this trend is difficult to reverse. However, if this were the only application of the theory, then free-marketeers would be only helpless onlookers in the relentless extinction of liberty. Fortunately, there is more to it than this.

The Adam Smith Institute was conceived as an antidote, as an organ for the other side of public choice—the theory of micropolitics. Public choice theory tells us that radical reforms will be resisted by organized interest groups. The micropolitical solution is to make small, gradual changes, "death by a thousand cuts," so that even if opponents realize what is planned, individual changes do not justify the commitment of resistance. Just as public choice theory explains that concentrated benefits accrue to organized lobbyists, micropolitics looks for groups with an interest in the maintenance of markets.

This approach has proved to be a stroke of genius. The first Thatcherite policy contrived with this in mind was the sale of public housing to private dwellers. At the start, the policy was denounced by opposition parties. Now the program has proved to be popular, and no party will risk alienating the thousands of voters who have benefited from it by threatening to repossess houses for the state.

The other policy formulated from the insights of micropolitics is the sale of state industries and public utilities. When the sale of British Telecom was first announced, telecommunications unions pledged obstinate resistance. The response was to give shares in the company to the workforce; consequently there was very little resistance. Whenever a sell-off occurs, preference in share allocations is given to small investors. This ensures that shares are widely distributed (the total number of individual shareholders has increased from 3 million to 8 million since 1979). Again, the Labour Party at first pledged to reclaim Telecom, but since then, realizing that this would not be welcomed by the 1½ million voters who hold shares, they have dropped the pledge.

In summary, the Thatcher government has its intellectual origins in the postwar revival of liberal economics. Policies have been successfully

implemented through a political strategy which circumvents opposition and gives visible benefits to new interest groups.

Signs of Progress

In the past I saw it as a limitation of micropolitics that the strategy relied upon a receptive government ear; I feared that a change in power could end the gains of eight years. Following developments in discussion among the Left, I now have fewer reservations. The fact is that the shift in ideological boundaries is not confined to the Conservative Party, but is in progress in all parties.

To illustrate, consider two recent articles. Colin Ward, writing in *The Guardian,* a soft socialist newspaper, called for the Left to abandon reflexive endorsement of state action:

> How sad that in Britain—birthplace of friendly societies, trade unionism and the co-operative movement—socialists should have been so intoxicated with power and bureaucracy and the mystique of the state, that they should dismiss their own inheritance as a path not worth taking. It's their own fault of course, for rejecting their history and origins for the sake of a version of socialism which is governmental, authoritarian, paternalistic and unloved.[2]

Similarly, David Selbourne, writing in the socialist journal, the *New Statesman,* argues that the Left should rediscover individualist roots:

> It was, in essence, a libertarian politics of working-class and community self-reliance, underpinned by a strong moral sense of citizenship, justice and individual entitlement. It is a legacy which the left and Labourism have squandered; much of its surviving impulse has been co-opted and rearticulated by the Toryism which is now in power.[3]

The Future

Acceptance of the market is now widespread. Within a decade the place of free enterprise no longer will be a matter of debate; its acceptance will be an unspoken presupposition upon which all debate proceeds.

Next the arguments must be won on social services—education, health care, and welfare payments. At the moment, a micropolitical plan is in progress to introduce, in stages, competition among schools. The aim is to avoid the organized hostility which meets education vouchers. The state National Health Service is yet to be tackled. Nor has a reform scheme been advanced for Social Security benefits and pensions. Reform has sufficient intellectual support; what is needed is a politically feasible method of introduction. These are the debates which will dominate the politics of the next ten years.

The last eight years have been a gain for economic freedom, but in the sphere of civil liberty, policy has followed a course of despotism. Britain has the strictest censorship of pornography in Western Europe. Following a scare campaign in the tabloid press, a law was passed in 1984 making the sale of "video nasties" a criminal offense. This scare ensued from the report of a Parliamentary Group Video Enquiry. Survey methods used in the enquiry were highly dubious, and the presentation of the report was partially selective and misleading.

To give one illustration, the popular press seized on the finding that 45.5 per cent of 7–16 year-olds had viewed at least one pornographic film. This figure includes, as the most widely seen film, "The Evil Dead," a film passed for viewing by the British Board of Film Censors and therefore, under the stated terms of the report, not illicit. It is hard to avoid the conclusion that the whole enquiry was conceived and staffed with the aim of making a case for legislation.

In common with the United States, the Conservative government has pursued an anti-drug campaign. In 1986 a Drug Traffic Act was passed which, in an abandonment of the principles of common law, provides that the assets of the accused may be seized, and thus makes a preliminary assumption of guilt. Evidence indicates that this whole policy has failed. The street value of heroin is largely untouched by customs seizures, suggesting that narcotics importers have no difficulty in eluding law enforcers. A significant source of illness among addicts is the use of contaminated syringes; the

purchase of sterile syringes is illegal so that users often share them, or use them more than once. Fears over the spread of AIDS brought home the discomfiting truth that government policy has been responsible for one problem which it was supposed to solve. In Scotland, where spread of the disease has been particularly rapid, addicts are now permitted to trade in used syringes for fresh ones.

The most recent target of criminal policy has been the use of offensive weapons. Talk of new restrictions on firearms was already in progress when a multiple murder occurred at Hungerford. A chorus of demands for tighter controls followed. Greater limitations have now been introduced on the possession of semi-automatic rifles, and it seems highly likely that new laws will follow relating to other weapons. This will not be an effective policy against crime, since crimes which yearly proliferate do not entail the employment of guns (and least of all machine guns). Knives have also now been the subject of stricter legislation. Again with disregard for the common law principle of demonstrated guilt, an intention of malicious use is now assumed.

The policies of the Conservative government originate in the ideological inclinations of groups within the Conservative Party. To simplify greatly, there are three factions: wets, old right, and libertarians. Wets are paternalists, in the tradition of Disraeli, who advocate a pragmatic, as opposed to ideological, approach to policy. They seek a return to the mixed economy consensus of postwar governments. Members of the old right are supportive of draconian law and order policies, advocate the imposition of reactionary moral standards, oppose immigration, and are quite enthusiastic about the free market.

The Thatcher government is founded upon the support of the old right and libertarians. This explains the need for the government to maintain support among the old right in matters of criminal policy.

In future years this alignment will change. Many of tomorrow's Conservative Party leaders will rise from the Federation of Conservative Students. This body became dominated by libertarians in the late 1970s, and was disbanded by the party in 1986 because its unconservative behavior had become an embarrassment to the government. By the time this ascendancy has come about, a large portion of the intellectual community will have been won over to the libertarian position on civil liberties, and public discussion will be under way. Those in the Conservative Party with an earlier libertarian background then will feel free to take openly the libertarian side in these debates. This shift in the focus of discussion will change the alignment of factions. In debates on drugs, pornography, and immigration the old right will line up with the wets to oppose libertarians. However, this does not mean that libertarians will lose because the sizes of factions will change also.

I noted above the growing acceptance of libertarian ideas across the political spectrum. If this continues, then fewer and fewer will hark back to the mythical golden age of the postwar consensus. In other words, there will be fewer Conservative wets. For those centrists who remain, the center will have moved, so that going along with the consensus will involve being more libertarian than it does at the moment.

On the left there has always been a current of libertarian thought. This stream is rarely manifested today because the focus of political discussion is on economic policy and on social services. The Left (other than a few dissidents) is not libertarian on economic policy, and rarely so on social services. The Left remains tethered to a command state outlook, and will continue to miss the political initiative for some time to come.

Optimism is justified. Hopeful predictions for the future of liberty cannot be dismissed as wishful thinking, because of the momentum behind the modern libertarian movement. While not denying the significance of our forebears, I regard our movement, in ideological consistency and in determination, as unique. My optimism is based on the sincere belief that the future is ours. □

1. John Blundell, "Privatisation—by Political Process or Consumer Preference?" *Economic Affairs*, Volume 7, No. 1.
2. *The Guardian*, October 12, 1987.
3. *New Statesman*, October 16, 1987.

A REVIEWER'S NOTEBOOK

Privatization

by John Chamberlain

Privatization goes slowly in America, but it is undeniably a world issue. E. S. Savas sums the story up ably in his *Privatization: The Key to Better Government* (Chatham House Publishers, Chatham, New Jersey, 308 pp., $14.95 paper, $25.00 cloth). Britain's Prime Minister Margaret Thatcher has led the way by her divestiture of either all or parts of state-owned enterprises including the aerospace industry, automobiles, radio, telecommunications, chemicals, oil, ferries, and hotels, involving a transfer of 400,000 jobs to the private sector. After privatization, the total profits in the first seven British enterprises to be denationalized rose by 49 per cent.

Practicality more than ideology has sparked the world divestiture movement. The dominant political party in Mexico would prefer to keep the state-owned services going if only to provide jobs for the faithful, but it is now selling off its hotel and automobile businesses. Both Argentina and Canada have appointed Ministers of Privatization. The Japanese have taken the first steps toward getting the telephone, tobacco, railroad, and airline enterprises out of government hands. In Brazil they are either selling or closing some of the 20,000 government-owned companies. Spain has chosen to turn textile, travel, tourist, truck, and automobile businesses over to the private sector, and Italy has sold shares in its largest bank and its pipeline-laying companies. In the Philippines, government-owned resort hotels, cement plants, soybean processing plants, pulp and paper mills, a shoe factory, and a copper mine have been put up for sale.

The most dramatic thing, says Savas, is what happened in China after the death of Mao Tse-tung. Here a billion people living in a totally collectivized state have been exposed to a form of privatization. "Farming communities," says Savas, "were disbanded and most farmland was returned to private ownership, with the result that food production skyrocketed." The Soviet Union's Mikhail Gorbachev has been following developments in China with an envious eye.

Savas, who sticks largely to generalized abstraction, is sparing with his individual anecdotes. But they crop up occasionally in interesting parentheses. In Britain there were no buyers for the state-owned cross-channel hovercraft ferry service. So the Thatcher government gave the company to the workers, who forthwith turned it into a profitable private enterprise.

Margaret Thatcher's prize exhibit is her sell-off of public housing to individual families. "In the first six years after being granted 'the right to buy,' " says Savas, "13 per cent of public housing tenants purchased their units, at discounts of up to 50 per cent. . . . "

The British experience with housing divestiture has excited some American legislators. But it would be impossible to replicate the British story in the United States. Fewer than 2 per cent of Americans live in public housing. Savas suggests that tenant management might solve some of the problems of this 2 per cent. He is also high on voucherization. The value of a housing voucher would be equal to the current annual subsidy per unit. Individual families

would be free to shop around for housing accommodation. "The effect," says Savas, "would be to integrate public housing into the local housing market, and to give freedom of choice to tenants who are now trapped—in effect, institutionalized—in public housing and have no chance to move."

Savas is quite aware of the libertarian objection to the use of vouchers, which would involve the use of taxpayer money. But it is practicality, not ideology, that guides Savas's pen. He is not after philosophical purity. What he wants is competition in as many fields as possible. It suffices for him that the Canadian Pacific railway, which is privately owned, can compel the government-owned Canadian National railway to meet its rates.

Housing vouchers and food stamps subsidize the consumer. Savas thinks that this is preferable to government ownership of housing units and farms. Governments all over the world have done badly when they have gone into direct production. In another of his few anecdotes Savas tells about the experience of tennis players in New York City. The city kept its public courts in such poor condition that the tennis players had to rent their own private courts. Eventually the city decided to lease its courts to private operators. It was a franchise operation.

Load-Shedding

Savas speaks of load-shedding or transfer by default. "The growth of private tennis facilities and private policing," he says, "are examples of this process." There is load-shedding by default in public education in large cities, where parents even of limited means have been withdrawing their children in droves and enrolling them in private schools.

Quite early in his book Savas makes a series of distinctions among ways of delivering goods and services. These ways can be categorized under the headings of "private, toll, common-pool, or collective goods." Ten different institutional arrangements or structures can be devised for delivery. They are direct government provision, intergovernmental agreements, franchising, contracting for service, voucher systems, grants, voluntary associations, self-help or self-service, the marketplace, and government vending.

The economic advantages of load-shedding are obvious. But Congress is not disposed to listen. "There is too much fun," says Savas, "in spending other peoples' money." In one-party countries the existence of such government-owned companies as Mexico's Pemex provides a convenient way of getting full employment. It hardly matters in government eyes that job redundancy imposes a tremendous cost on all citizens, although over-staffing and over-building detract in obvious ways from efficiency.

In Russia it will take more than *glasnost* and *perestroika* to bring a halt to over-staffing. But a beginning can be made if Gorbachev, harkening back to the Lenin NEP period, decides to let the peasants make their own planting and marketing arrangements. A prosperous peasantry would mean that fewer people would be seeking city jobs.

In America, the post office is a prime candidate for privatization. This is something that is brought home to me as I rush to get this review into the mail before a first-class stamp goes to 25 cents. □

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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Thomas C. Stevens, chairman; Ridgway K. Foley, Jr., vice-chairman; Paul L. Poirot, secretary; H.F. Langenberg, treasurer.

The costs of Foundation projects and services are met through donations. Donations are invited in any amount. Subscriptions to *The Freeman* are available to any interested person in the United States for the asking. Additional single copies $1.00; 10 or more, 50 cents each. For foreign delivery, a donation of $15.00 a year is required to cover direct mailing costs.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

Chip Cartel: An Update

In the February 1987 issue of *The Freeman,* Michael Becker reported on the agreement between the United States and Japan to fix minimum prices for computer memory chips, assign market quotas for these chips, and guarantee that the Japanese would not undercut the agreement with sales in third countries. He predicted that "consumers will likely pay hundreds of millions of dollars more for home computers, videocassette recorders, microwave ovens, and other products which use computer chips."

Little more than a year later, on March 12, 1988, *The New York Times* reported:

"Prices for memory chips have doubled or tripled in recent months as customers clamor for supplies. Soaring prices and limited supplies of vital components have prompted manufacturers of computers and other electronic equipment to raise their own prices, slow their assembly lines and delay introducing products that require large amounts of memory. Profits are likely to suffer and some layoffs may follow.

"Although the shortage reflects several forces within the electronics industry, the one receiving the most attention is the agreement signed by the Governments of the United States and Japan in the summer of 1986."

Funny Money

"Last month, the newspaper *Sovetskaya Kultura* published a letter from a dispirited Odessa film director complaining about all the privileges available to foreign tourists and to Russians who use foreign currencies or coupons.

"Reporting that ordinary Soviet citizens were refused service at many places along the Black Sea coast because they lacked foreign money, he recalled a brief conversation with a Russian child from the area. 'Vovochka, what do you want to be when you grow up?' he asked. 'A foreigner,' she replied."

—from *The New York Times,* July 22, 1987.

Training Wheels

In the late 1970s, the National Highway Traffic Safety Commission, a federal regulatory agency, became alarmed by the high accident rate of motorcyclists. At great expense, NHTSC ordered the construction of a radically new motorcycle, which would steer with the rear wheel, not the front. The prototype was found to be much safer, far more stable, at all speeds over 30 m.p.h. However, at all speeds less than 30 m.p.h., the prototype fell over, crushing the rider's leg. The Commission was undaunted: it added two training wheels to the machine. Thus it succeeded in producing the world's safest motorcycle, while at the same time proving beyond doubt that the safest motorcycle is an automobile.

—JOHN ADAMS WETTERGREEN
of San Jose State University,
speaking before The Heritage Foundation,
February 11, 1988

Medicare in Australia

State hospitals require a large share of the taxpayer's dollar. The government has many ways of controlling hospital expenditures, but the most effective is simply by closing them under the guise of "rationalization." In hospitals that still are functioning, wards are closed and many beds are empty, despite ever-longer waiting lists. While the government makes excuses that the wards need repainting or refurbishing, the truth is that there are not enough nurses willing to accept current salaries and working conditions.

Not content with controlling just the state-owned hospitals, the Socialists now are trying to control the private hospitals. Private patients' Medicare reimbursements have been reduced for procedures done in private hospitals, while their contributions to private hospital insurance funds have soared because of the diminishing pool of contributors. Physicians who own private hospitals are accused of profiteering, and patients are warned away. Small private hospitals face closure when they fail to meet standards set by a government-supported committee—standards that state hospitals are not required to meet.

Meanwhile, state hospitals are so besieged with people wanting free treatment that their waiting lists have become a public scandal.

—PETER C. ARNOLD, M.D., writing in the February 1988 issue of *Private Practice*

An Army of Principles

"An army of principles will penetrate where an army of soldiers cannot. Neither the Channel nor the Rhine will arrest its progress. It will march on the horizon of the world and it will conquer." This is the inscription on one side of Rose Wilder Lane's tombstone in a Mansfield, Missouri cemetery.

—CARL WATNER, Editor
The Voluntarist

Clarification

"Freedom Footnote," by Paul Rux, which appeared in the April 1988 *Freeman,* contained a quotation from *School Finance: The Economics and Politics of Public Education,* by Walter I. Garms, James W. Guthrie, and Lawrence C. Pierce. The article should have mentioned that the original source of the quotation is James M. Buchanan, "Economics and Its Scientific Neighbors," in Sherman Roy Krupp, ed., *The Structure of Economic Science: Essays on Methodology.* We apologize for this oversight.

—BJS

Reader's Digest Reprints "David"

"David: From Beggar to Entrepreneur—In a Day" by Bruce Alan Johnson was reprinted in the June 1988 *Reader's Digest.* This article originally appeared in the November 1987 issue of *The Freeman.*

We have extra copies of the *Digest* version of Mr. Johnson's article. Please write to FEE, stating the quantity you'd like.

THE FREEMAN
IDEAS ON LIBERTY

The Wall Street Journal's Second Language

by William H. Peterson

Why the growth of *The Wall Street Journal?*

In November 1883, Wall Street news agents Charles H. Dow and Edward D. Jones introduced their first publication, "Customers' Afternoon Letter," two pages which summarized messenger-delivered, hand-written financial bulletins (onion-skin carbon copies called "flimsies") which they had issued during the day. A year later the "Letter" published the first Dow Jones Stock Price Index.

With subscriber and advertiser lists growing and reaching beyond downtown Manhattan, the two entrepreneurs hit on a rather radical idea—a daily *financial* newspaper. On July 8, 1889, the first issue of *The Wall Street Journal* rolled off the presses. It was four pages in length and cost two cents. In 1902 circulation hit 7,000, in 1927 40,000, in 1947 100,000.

Today, with more than two million daily circulation and an estimated readership of five million, and with 18 printing plants across the nation linked by a satellite facsimile transmission system, the *Journal* is America's largest daily newspaper. It proclaims itself "the daily diary of the American dream." Pulitzer Prize judges and schools of journalism have acclaimed its well-written English, its smoothly flowing text, its investigative "scoops."

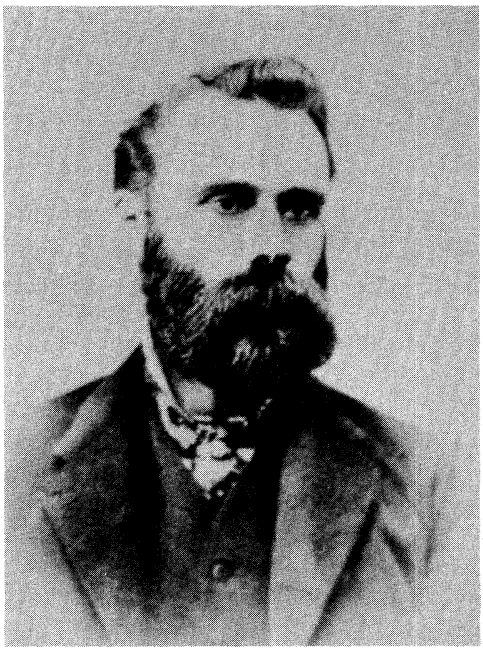
To me, though, the growth of *The Wall Street Journal* is mainly attributable to its remarkable second language—prices. Prices, like music, are a common tongue, a universal language, even understood by the illiterate. It is a language also copiously available, of course, in the business sections of city papers across the country and in other financial publications such as *Investor's Daily* and *The Journal of Commerce*.

For its part, the *Journal* publishes a torrent of daily financial data, with scores of tables, charts, bar graphs, rates, and indexes. The Dow Jones Stock Price Index of yore, for example, has now evolved into an Industrial Average of 30 stocks, a Transportation Average of 20 stocks, a Utilities Average of 15 stocks, and a 65-Stock Composite.

Prices of stocks and bonds are covered not only in exchanges such as New York (popularly known as the Big Board), American, Boston, Philadelphia, Midwest, and Pacific, but in over-the-counter (NASDAQ) markets. Foreign stock markets reported include Toronto, Montreal, London, Amsterdam, Brussels, Frankfurt, Zurich, Paris, Milan, Stockholm, Hong Kong, Sydney, and Tokyo.

Too, of special interest to speculators and hedgers, the *Journal* (as do most financial sections) details daily commodity cash or spot prices as well as expected future prices (called futures) such as those for soybeans, gold, cotton, coffee, crude oil and other raw materials, and for financial futures such as British pounds, Japanese yen, Canadian dollars, Swiss francs, interest rates, and stock indexes (notably the Standard & Poor's 500).

Dr. Peterson, an adjunct fellow at The Heritage Foundation, is a Washington, D.C., consulting economist. For fourteen years he wrote The Wall Street Journal*'s "Reading for Business" column.*



Charles H. Dow, cofounder of *The Wall Street Journal*

Daily interest rate and yield figures are also reported. Money rates include those for the prime, federal funds, discount, mortgages, call money, commercial paper, certificates of deposit, bankers acceptances, London late Eurodollars, London interbank offered rates (LIBOR), foreign prime, Treasury bills, and Federal Home Loan Mortgage Corporation (Freddie Mac).

So the *Journal* offers, in its second language, literally thousands of prices and price-related figures on a daily basis, with all manner of weekly, monthly, and quarterly summaries, with even, in a special section, a yearly summary, the last one dated January 4, 1988, and headlined "Crash Casts a Giant Shadow on Investment Outlook."

Hence what the reflective reader of the *Journal* or any other financial section sees is a moving panorama of economic, business, and financial news, almost all bearing directly or indirectly on prices.

Reflecting further, that reader may also see in those prices the broad sweep of a market society, of a global economy, of supply and demand at work to help satisfy human needs and wants—of division of labor and social cooperation in action.

But how and why do masses of people cooperate—people who, for the most part, don't know each other, who perhaps are separated by thousands of miles, who quite conceivably speak different languages, hold different customs, practice different cultures, and may even be, here and there, on unfriendly terms with each other?

Consider. The *Journal* reader wakes up via his Hong Kong-produced alarm clock-radio, switches on the lights powered by electricity carried on copper mined in Chile, reads his morning *Journal* printed on Canadian newsprint, drinks his Brazilian coffee, eats wheat flakes from grain farmed in Kansas, consumes a banana grown in Ecuador, puts on his clothes made of Alabaman cotton and Australian wool, and drives to his office on tires made partly from Malaysian rubber, using gasoline refined from oil pumped in Saudi Arabia.

In such remarkable seemingly mindless global integration and peaceful cooperation—without, in the main, the intervention of government—we witness what Leonard Read called "the miracle of the market."

This is social cooperation, Adam Smith's invisible hand, F. A. Hayek's division of knowledge, Ludwig von Mises' praxeology—the science of human action—at work, all knit together by prices, by everybody's second language, by a vast globally connected price network. These prices may be expressed in different currencies. No matter. Currencies translate readily into each other in the marketplace, so that whatever the good, the Mexican peso price and the comparable U.S. dollar price are interchangeable, as the American tourist in Acapulco soon finds out.

Human incentives—human nature—are also at work. These are the incentives impelling the reader of the *Journal* and of financial sections generally. Producers and consumers, buyers and sellers, savers and investors, dealers and speculators, hedgers and bankers, brokers and commission agents, private individuals and corporate executives, and many others (including quite a few college and university business and economics students and their professors)—all communicate or try to communicate with each other *through prices* as they pore over financial pages, driven by innate incen-

tives, broadly by the will to live and, if possible, to live better, as each views life.

But to live is to choose, to exchange one state of affairs for another. An exchange may be autistic, within oneself, swapping, say, working time for leisure. Or an exchange may be social, involving another person. Whatever the type of exchange, the human family around the globe invariably engages in what Mises referred to as catallactics, the subjective determination of ratios of exchange or prices within broad margins.

Exchanges—this for that—are motivated strictly by gain, by a sense of improvement. Thus a market exchange is—to quote from Mises—"effected only if each party values what he receives more highly than what he gives away." Price or a perceived favorable cost-benefit relationship is hence central to any exchange.

Market Exchanges

Market exchanges, then, are at once both intrapersonal and interpersonal. The buyer values, intrapersonally, the good more than the money, just as the seller values the money more than the good. If so, a transaction generally takes place, interpersonally, with gain perceived by both parties. What the buyer regards as a purchase is regarded by the seller as a sale.

And so through prices, subjectively determined, through free markets, the national and international division of labor, the broad sweep of individualistic human action the world over, the intricate link-up of differing currency and financial systems, the diverse work of various market societies, here and abroad, go forward, price by price, transaction by transaction—social cooperation literally on a global scale.

Worldwide mutuality and sociability emerge. The individual, from one ethnic origin to another, from one culture to another, from one race to another, serves so as to be served. And society tends to become peaceful and progressive.

Also central to this pricing and division of labor process is the role of the entrepreneur. The entrepreneur is the spark of the free enterprise system, a profit-seeker and opportunity-discoverer, an innovator and initiator, alert to prices and inadequate market responses in ever-dynamic commerce. He is in this sense something of an arbitrager and speculator. He buys when and where he thinks the price is too low. He sells when and where he thinks the price is too high.

For the entrepreneur, then, gnawing questions: When? Where? How? For many an entrepreneur, apart from the investor, speculator, business executive, etc., the financial pages mark a starting place to search out market opportunities, find entrepreneurial ideas, keep "abreast of the market" (to quote a *Journal* feature).

Thus in one way or another the entrepreneur discovers, advertently or inadvertently, unmet or imperfectly met market demands or social needs, perhaps employing formal market research, perhaps not. In any event, he tries to anticipate future prices, knowing that if he anticipates wrongly, he incurs a loss.

On discovering what he thinks is a market opportunity, he dickers with the owners of the factors of production—land, labor, capital—and is thereby intimately concerned with their prices—rent, wages, interest rates—with income and outgo. If he projects a profit, he may undertake production and scout consumers for his wares, attracting them, perhaps with advertising, on the basis of price, quality, or convenience—or possibly some combination of the three (although quality and convenience are at bottom but aspects of price).

Without the entrepreneur, the wheels of commerce and industry would not turn. The story of Charles Dow and Edward Jones and their founding of *The Wall Street Journal* is not untypical of entrepreneurship and its discovery process.

So throughout the process (call it capitalism or the profit-and-loss system) prices serve as guideposts for entrepreneurship and society, and serve as man's universal language, a language spanning continents and frequently moving with electronic speed—Hong Kong to New York, for example, in nothing flat.

The language addresses everyone, and everyone listens, hard usually, as in the reading of a will. This language is mostly quantitative and assumes many forms—wages, employee benefits, interest rates, rents, profits, losses,

legal fees, insurance premiums, jury awards, speech honoraria, school tuition, bridal dowries, product prices, monthly payments, discount coupons, convenience factors, betting odds, unit costs, "frequent flyer" tickets, and so on.

Coordinating Production with Consumption

Prices communicate. Sometimes loud and clear. Sometimes quietly and subtly. Price movements, for example, can signal oversupply or undersupply, overdemand or underdemand, and thereby act so as to wipe out shortages, on the one hand, and surpluses, on the other. Prices thereby serve in market societies to coordinate production with consumption, with the consumer in the driver's seat (with "consumer sovereignty," to use the phrase coined by W. H. Hutt).

So prices serve as human incentives—the seller fascinated by high prices, the buyer by low prices—to create wealth and serve others, to forge capital and boost productivity, to stimulate entrepreneurship and steer the production of goods and services toward society's most urgent needs, as reflected in an ever-shifting network of prices, all with implied profit opportunities, both for the producer and the consumer—the seller and the buyer.

Too, in this pricing process of supply and demand—which can be seen, if imperfectly, in the financial pages—society *simultaneously* achieves three key market phenomena: price determination, production direction, and income distribution. The interventionist or socialist tends to think of these three as separate actions and hence each capable of "helpful" government manipulation. Not so. But let Mises speak from *Human Action:*

> The pricing process is a social process. It is consummated by an interaction of all members of the society. All collaborate and cooperate, each in the particular role he has chosen for himself in the framework of the division of labor. Competing in cooperation and cooperating in competition all people are instrumental in bringing about the result, viz., the price structure of the market, the allocation of the factors of production to the various lines of want-satisfaction, and the determination of the share of each individual. These three events are not three different matters. They are only different aspects of one indivisible phenomenon which our analytical scrutiny separates into three parts. (3rd edition, p. 338)

Mises was of course a champion of free markets, of seeing how government intervention into peaceful private activity tends to make things worse rather than better. And daily are the *Journal* and the financial press generally supplied with stories and editorials on the boomerang effects of rent controls, farm subsidies, import tariffs, minimum wages, welfare payments, and other forms of price control—democratic government's favorite intervention. In the words of Mises: "A government can no more determine prices than a goose can lay hen's eggs." (*Human Action,* 3rd edition, p. 397)

Prices. Catallactics. Human incentives. Human action. This is what the financial press stresses, especially in its second language. This language of prices is universal. It talks. It shouts. It moves people. On all continents. It also sells *The Wall Street Journal.* □

IDEAS ON LIBERTY

Prices and People

The free price mechanism, by preventing waste and by giving swift directions to capitalists, which must be obeyed on pain of bankruptcy, has made the multiple economy the most efficient system for supplying the wants of the people that the world has ever known.

—GEORGE WINDER

The Senseless Slander of Services

by Russell Shannon

People who urge an expanded role for government in our economy certainly deserve an award for persistence! When one of their arguments collapses, they relentlessly erect another.

Over the past few years, for example, there has been much ado about our emerging "rust belt." Often due to the pressures of foreign competition, many manufacturing facilities have closed. Widespread calls have rung out for government intervention in the form of "industrial policies" and trade barriers against imported goods.

By and large, however, we seem to have suffered only a temporary setback. As measured by the Federal Reserve Board's index of industrial production, manufacturing output is now well above the peak achieved in 1979 just prior to the recession of the early 1980s. Of particular importance is the fact that, over the past two years, the falling exchange value of the U.S. dollar has spurred our export industries.

However, alarmists still complain that employment in manufacturing remains well below the 21 million workers who had jobs in that sector in 1979. But they ignore the fact that the unemployment rate for the economy as a whole is falling, and the overall employment rate has reached unprecedented levels. Apparently, these displaced workers are finding jobs, many of them in the service industries. We thus are continuing a trend which originally shifted workers from farms to factories: output in both agriculture and manufacturing continues to rise while employment falls, due to impressive gains in productivity.

Yet critics of laissez faire still are not content. Now they scoff that soon we may all be flipping hamburgers or pumping gas. But the service sector does not deserve such derision. It encompasses far more than fast-food restaurants and service stations. After all, this category includes medical personnel, teachers, journalists, lawyers, and entertainers, among many others. And not only are many of these service jobs crucial to our welfare and culture; they also quite likely provide far more satisfaction and fulfillment than one can find in the drudgery of hanging left front doors on an endless assembly line of automobiles, or in filling empty boxes with shoes.

Even the derision often directed at jobs in fast-food businesses is misguided. Writing in the August 31, 1987, issue of *Fortune* magazine, Jeffrey Campbell, an executive vice president at Pillsbury, pointed out that such jobs can be "a very large port of entry for disadvantaged young people into the mainstream of the American economy." And he can back up his statement with facts: "A lot of our managers started in hourly paid jobs. Two regional vice presidents in our Burger King division rose from jobs behind the broiler without college degrees."

What's more, William Johnston of the Hudson Institute has discovered, as a result of a careful statistical analysis, that the shift to services can be a boon to economic stability. Because "employment and production in service industries are more stable than in the goods economy," he writes in the December 10, 1987, *Wall Street Journal,* we are less likely to suffer the pains of economic recession. People may be able to postpone buying a new car or refrigerator if times get bad, but they are not so apt to cut back on services. Thus, they are more likely to maintain demand and, as a result, employment.

There has been great interest of late about *perestroika* (restructuring) in the Soviet Union. Quite obviously, our economy is experiencing its own restructuring. Would it not be ironic—even tragic—if, at the same time, the government of the Soviet Union restructures its economy by attempting to *reduce* centralized control, we foolishly were to go in the *opposite* direction? □

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The Sound of the Machine

by Mike W. Perry

Everything they saw that day, from the vast fields of ripening grain to the numerous children, spoke of fertility. Nothing, it seemed, could change the vitality of these people. As Martin and Karl drove from village to village their faces grew increasingly grave.

In the evening the men returned. Martin told of all the children he had seen and warned that, "someday they may give us a lot of trouble" because they were "brought up in a much more rugged way than our people." Alarm spread through the group until the group's leader began to speak.

Obviously peeved, he pointed out that someone had suggested that abortion and contraceptives should be illegal here. He continued, "If any such idiot tried to put into practice such an order . . . he would personally shoot him up. In view of the large families of the native population, it could only suit us if girls and women there had as many abortions as possible. Active trade in contraceptives ought to actually be encouraged."[1]

The date was July 22, 1942. The place was the "Werewolf" headquarters in the Soviet Ukraine. The group's leader and abortion advocate was Adolf Hitler. The two men were Martin Bormann, his Secretary, and Karl Brandt, his personal physician.

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Operation Blue, the 1942 German offensive in the East, had been under way for almost a month and already its success was assumed. At Hitler's headquarters thoughts turned to what should be done with the occupied territories. Some wanted a lenient policy to gain Ukrainian support in the war against the Soviet Union. Others wanted to eliminate the Slavic population to make room for Germans.[2]

As Bormann hoped, that evening Hitler chose the second policy and the next day he told Bormann to issue population control measures for the occupied territories. Bormann developed an eight-paragraph secret order which included the following: "When girls and women in the Occupied Territories of the East have abortions, we can only be in favor of it; in any case German jurists should not oppose it. The Führer believes that we should authorize the development of a thriving trade in contraceptives. We are not interested in seeing the non-German population multiply."[3]

This was not the first such policy. On November 25, 1939, shortly after the Nazi occupation of Poland, the Commission for Strengthening of Germandom issued a circular containing the following:

> All measures which have the tendency to limit the births are to be tolerated or to be supported. Abortion in the remaining area [of Poland] must be declared free from punishment. The means for abortion and contraceptive means may be offered publicly without any police restrictions. Homosexuality is always to be declared legal. The in-

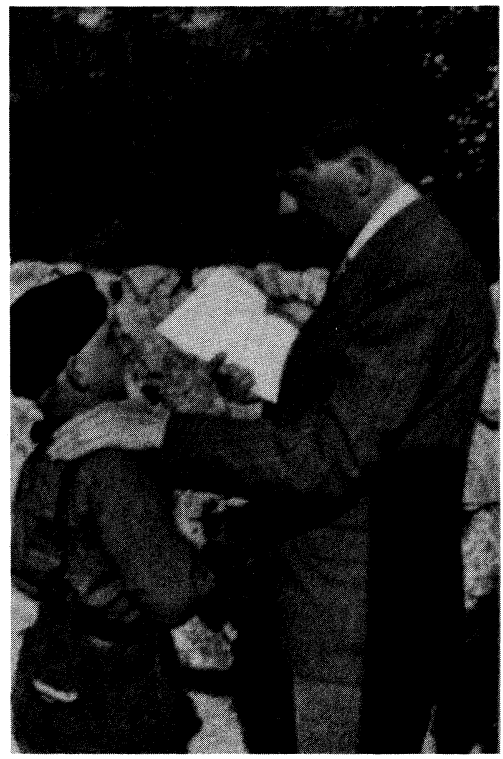
stitutions and persons involved professionally in abortion practices are not to be interfered with by police.[4]

This policy was confirmed on May 27, 1941, at a Ministry of the Interior conference in Berlin. There a group of experts recommended population control measures for Poland that included authorization of abortion whenever the mother requested it.[5] On October 19, 1941, a decree applied the measures to the Polish population. Hitler's July 23, 1942, decree extended it to other parts of Eastern Europe.

German experts also worked out practical ways to control population. On April 27, 1942, in Berlin, Professor Wetzel issued a memorandum suggesting ways to deceive people. It included the following:

> Every propaganda means, especially the press, radio, and movies, as well as pamphlets, booklets, and lectures, must be used to instill in the Russian population the idea that it is harmful to have several children. We must emphasize the expenses that children cause, the good things that people could have had with the money spent on them. We could also hint at the dangerous effect of child-bearing on a woman's health.
>
> Paralleling such propaganda, a large-scale campaign would be launched in favor of contraceptive devices. A contraceptive industry must be established. Neither the circulation and the sale of contraceptives nor abortions must be prosecuted.
>
> It will even be necessary to open special institutions for abortion, and to train midwives and nurses for this purpose. The population will practice abortion all the more willingly if these institutions are competently operated. The doctors must be able to help without there being any question of this being a breach of their professional ethics. Voluntary sterilization must also be recommended by propaganda.[6]

The planning for this goes back still further. In the summer of 1932, almost a year before the Nazi Party took power in Germany, a conference took place at the party headquarters in Munich. It discussed Eastern Europe and assumed Germany would someday conquer the region.



Adolf Hitler with a member of the Hitler Youth in the 1930s.

Agricultural experts pointed out that controlling Eastern Europe would make Germany self-sufficient in food but warned that the region's "tremendous biological fertility" must be offset with a well-planned depopulation policy. Speaking to the assembled experts Hitler warned, "what we have discussed here must remain confidential."

Not all Nazi insiders remained silent though. Hermann Rauschning, a prominent Nazi in the early thirties, defected in the mid-thirties and tried to warn of Hitler's plans. In *The Voice of Destruction* he described a 1934 conversation with Hitler about the Slavs.

> "We are obliged to depopulate," he went on emphatically, ". . . . We shall have to develop a technique of depopulation. . . . And by remove I don't necessarily mean destroy; I shall simply take systematic measures to dam their great natural fertility. . . .
>
> "The French complained after the war that there were twenty million Germans too many. We accept the criticism. We favor the planned control of population movements.

But our friends will have to excuse us if we subtract the twenty millions elsewhere."[7]

Within Germany itself, Hitler also advocated government-supported birth control to weed out those deemed "unfit." In his 1924 *Mein Kampf,* Hitler wrote that one of the seven major responsibilities for government was "to maintain the practice of modern birth control. No diseased or weak person should be allowed to have children."[8]

Once in power, Hitler wasted no time in legalizing eugenic sterilization and abortion. Gitta Sereny describes what happened this way: "The 1933 law for compulsory sterilization of those suffering from hereditary disease was followed two years later, on October 8, 1935, by the *Erbgesundheitsgesetz*—the law to 'safeguard the hereditary health of the German people.' This expanded the original law by legalizing abortion in cases of pregnancy where either of the partners suffered from hereditary disease."[9]

Within Germany, however, these "negative eugenic" policies were paralleled by positive programs to encourage births among the fit. Laws were passed limiting access to birth control and prohibiting abortion. Government programs encouraged large families.

These positive programs, along with the need to keep secret why Germany was so willing to help Slavs limit their births, created a confusion about Nazi policy that led to Hitler's remark about "shooting up" anyone who tried to ban abortions in the Ukraine.

For instance, in the spring of 1942, SS Reichsführer Himmler had to get the chief of German police in Poland, SS-General Krueger, to intervene so the courts would no longer punish Poles for having abortions. Similar court behavior in Byelorussia led SS-General Berger to remark that some German administrators, "have no idea what the German Eastern policy really means."[10]

From beginning to end, Nazi policies expressed not only their peculiar views of race but a consistency demanded by the logic of socialism itself. Hitler explained it to Rauschning this way:

> At its most revolutionary, Nazi policy aimed to socialize people, not property. Hitler once commented, "Our socialism is much deeper than Marxism. . . . It does not change the external order of things, but it orders solely the relationship of man to the state. . . . What do we care about income? Why should we need to socialize the banks and factories? We are socializing the people."[11]

Society as a Machine

Socialists see human society as a machine, not a living organism. At first, their machine may engulf only the larger elements of the society, the "banks and factories." But with time it takes over more and more until the people themselves are swallowed up. Human reproduction, like factory production, must come under state control. As Hitler noted, Nazism merely skipped the preliminary stages for the critical one.

In spite of worldwide condemnation of Nazi atrocities, some people in the United States found their population control policies attractive. Given its socialist underpinnings, it isn't surprising that the ideas would especially appeal to those ideologically closest to socialism, New Deal liberals.

President Franklin Roosevelt, for instance, found Hitler's ideas on birth control amusing. In *Allies of a Kind* the British historian Christopher Thorne describes what happened this way:

> Subjects to do with breeding and race seem, indeed, to have held a certain fascination for the President. . . . Thus, for example, Roosevelt felt it in order to talk, jokingly, of dealing with Puerto Rico's excessive birth rate by employing, in his own words, "the methods which Hitler used effectively." He said to Charles Taussig and William Hassett, as the former recorded it, "that is all very simple and painless—you have people pass through a narrow passage and then there is a brrrrr of an electrical apparatus. They stay there for twenty seconds and from then on they are sterile."[12]

Fortunately, FDR's information was inaccurate. The Nazis had hoped to sterilize people while they filled out forms at a counter, not

while passing through a narrow passage. But they found that the dose required to sterilize also left obvious burns, making it impossible to keep the sterilization secret.

Nazi attempts secretly to sterilize large populations indicate how population controllers often begin with measures that allow "freedom of choice." But if their goals aren't met, they won't hesitate to use as much coercion as necessary. FDR's comments show that coercive birth control can be attractive even to those who, in general, believe in democracy. The crucial factor is an ideological commitment to a controlled, planned society.

In the United States, the idea that the state should control human reproduction was first promoted by the birth control groups of the 1920s and '30s. Like Nazism, these groups broke society into two major groups, the "fit" (generally equated with the affluent) and the "unfit" (the poor). The only real difference lay in emphasis. Nazis wanted to raise the birth rate of the fit and lower that of the unfit. The birth control groups wanted only to "stop the multiplication of the unfit."[13]

Birth controllers also hoped to "socialize people" to the machine. For instance, in 1935 a sociologist named James Bossard wrote in *The Birth Control Review:*

> The demand for unskilled labor has been declining . . . but it is in this group . . . that the reproductive rates are highest. . . . As the demand for unskilled, low intelligence labor decreases, corresponding readjustments must be made in the supply of this type of labor, if we are to avoid the crystallization of a large element in the population who are destined to become permanent public charges. This points again directly to birth control on a scale which we have not yet fully visioned.[14]

In March 1939 Margaret Sanger, founder of the American Birth Control League, wrote a letter describing what her group was doing. She tells what Bossard's "not yet fully visioned" plans mean—massive government involvement in birth control through the social welfare and public health system:

> . . . statisticians and population experts as well as members of the medical profession had courage to attack the basic problem at the roots: That is not asking or suggesting a cradle competition between the intelligent and the ignorant, but a drastic curtailment of the birth rate at the source of the unfit, the diseased and the incompetent. . . . The birth control clinics all over the country are doing their utmost to reach the lower strata of our population, but as we must depend upon people coming to the Clinics, we must realize that there are hundreds of thousands of women who never leave their own vicinity . . . but the way to approach these people is through the social workers, visiting nurses and midwives.[15]

During the war, public outrage at Nazi ideology forced American birth control groups to stop talking about the "unfit." By 1942 the various birth control groups had merged to form the Planned Parenthood Federation of America. The new name, however, didn't mean that these groups had abandoned their plans. Linda Gordon explains it this way:

> "Planned parenthood" seemed a more positive concept than "birth control" especially to those who were general advocates of the importance of planning. Presumably "birth control" left matters such as population size and quality to the anarchism of individual, arbitrary decision. The propaganda of the birth-control organizations from the late 1930s through the late 1940s increasingly emphasized the importance of over-all social planning. A Birth Control Federation of America poster read: "MODERN LIFE IS BASED ON CONTROL AND SCIENCE. We control the speed of our automobile. We control machines. We endeavor to control disease and death. Let us control the size of our family to insure health and happiness."[16]

As the poster notes, these people believed that family size, like highway speed limits, should be a matter of law and public policy. "Planned parenthood" is thus similar to the planned economies of socialist countries and "family planning" to urban planning.

The poster's reference to "modern life" as being based on "science" refers to the other aspect of the family planning groups, their use

of pseudo-science (especially statistics) to promote their programs.

During the twenties and thirties, eugenic fears were common among the educated classes of the industrialized nations. Modern medicine, it was believed, enabled the unfit to live and reproduce in large numbers. Birth control groups used these fears to get support for their clinics. Birth control would provide "quality control" for the human factory.

After Nazism discredited these eugenic arguments the same people (now with "family planning agencies") dropped their language about unfit genes and began talking about a poor environment. By the sixties they had adopted another machine analogy, production control, to justify themselves. As birth control curtailed the birth rate of the unfit, so family planning would advert a "population explosion."

Like the earlier arguments, the warning about a population explosion, while totally wrong, had the appearance of truth. The children of the postwar baby boom were creating social unrest on the campuses and in inner cities. It really did look like we were having too many children.

In reality, with the arrival of the birth control pill in 1960, the nation's birth rate nosedived. By the late sixties when rhetoric about a "population bomb" hit its peak, it was obvious that the nation was actually in the midst of a birth dearth. In 1972 the nation's birth rate dropped below the replacement level and a decade and a half later it shows no sign of rising.

The fears of a population explosion in this country were unfounded but they made an excellent argument to get Federal funding for family planning programs and to legalize abortion. These programs helped target one of the main groups in the country with above-average birth rates, the poor underclass. (The other is conservative religious groups.)

Because Catholic immigrants were an early target of birth controllers, Catholic leaders understood this better than anyone else. In August 1965 William Ball, General Counsel of the Pennsylvania Catholic Conference, testified to a Senate subcommittee considering government funding for family planning services and warned that: "We have a particular concern over this because we believe that if the power and prestige of government is placed behind programs aimed at providing birth control services to the poor, coercion necessarily results and violations of human privacy become inevitable."[17]

William Ball's warnings have proved correct. In a news article in the June 6, 1969, issue of *Medical World News,* Dr. Alan Guttmacher, president of Planned Parenthood-World Population, used the same word, coercion, to describe what he felt would be necessary if voluntary means failed. He noted that: "Each country will have to decide its own form of coercion, and determine when and how it should be employed. At present, the means available are compulsory sterilization and compulsory abortion. Perhaps some day a way of enforcing compulsory birth control will be feasible."[18]

One of the countries where Dr. Guttmacher felt coercion would be needed was mainland China. In the past decade Planned Parenthood has been helping the Chinese government set up a population control program. A 1985 article in the *Washington Post* described the result:

> . . . China, to be sure, is curbing its population growth, but its success is rooted in widespread coercion, wanton abortion and intrusion by the state into the most intimate of human affairs.
>
> "The size of the family is too important to be left to the personal decision of a couple," Minister of Family Planning Qian Xinzhong explained before resigning last year.
>
> "Births are a matter of state planning, just like other economic and social activities, because they are a matter of strategic concern," he said. "A couple cannot have a baby just because it wants to."[19]

In 1979 China's Vice Premier Chen Muhua explained the relationship between his country's socialism and coercive population control this way: "Socialism should make it possible to regulate the reproduction of human beings so that population growth keeps in step with the growth of material production."[20]

Such open socialism has never been popular in the United States and our laws make it almost impossible to use the degree of coercion

used by mainline China. However, as William Ball warned, this doesn't mean that government and family planning agencies can't use other means to coerce women into abortion.

For instance, a recent issue of the *Journal of the American Medical Association* featured an exchange of letters about whether Center for Disease Control guidelines should recommend abortion when the mother was carrying the AIDS virus. Louise Tyrer of Planned Parenthood, among others, wanted the pro-abortion guidelines. Others objected for the following reason:

> Some of their objections were based on the fact that since not all children born of AIDS-infected women are afflicted with AIDS, some women might wish to carry pregnancy to term and should not be pressured toward another course of action by the federal government. Vigorous objection was made because of the belief, based on past practice, that minority women in public clinic settings would be coerced into having abortions using these guidelines as the basis.[21]

There is a warning here. In comparison to the limited resources of any individual, the power of the government (and quasi-government agencies) is immense. When that individual is young, poor, minority, and female that power is multiplied many times. As the Center for Disease Control consultants noted, abortion for these women is often coerced, not chosen.

It matters little that these coercive planners believe they can create a perfect world. As Charles Frankel, Old Dominion professor of philosophy and public affairs at Columbia University, wrote in *Commentary:*

> The partisans of large-scale eugenic planning, the Nazis aside, have usually been people of notable humanitarian sentiments. They seem not to hear themselves. It is that other music that they hear, the music that says that there shall be nothing random in the world, nothing independent, nothing moved by its own vitality, not out of keeping with some Idea; even our children must be not our progeny but our creations.[22]

Their music is the music of a machine; a machine made from the bodies of each of us. □

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A Strange Indifference

by Andrew E. Barniskis

An unusual thing happened to me one night several months ago. I had worked late in my home office, and my wife had fallen asleep with the bedroom television on. As I prepared for bed, a late-night talk-show was being broadcast.

The talk-show guest was a well-known consumer advocate, who was crowing about his success at having a certain controversial but otherwise harmless product outlawed in many cities and tightly regulated in a few states. I watched for a few minutes with no particular interest, and then it struck me how strange that was—that I had no particular interest.

My "arguments with the television" are somewhat of a family joke. Indeed, it had been unusual for me to get through a newscast without becoming livid over the course of local and national events. Yet there I was, listening to a recital of how one more freedom of choice was being eliminated, and I really didn't care. That startled me.

It wasn't fatigue. I'm a night person, and usually have to force myself to bed. It wasn't preoccupation. I had completed the task I had been working on, and felt satisfied with my accomplishment. Perhaps, I thought, I had been emotionally drained by recent months, and the increasing attacks on our liberties.

I had been angered at having to obtain a Social Security number for my ten-year-old son. I was depressed by calls for tighter regulation of financial markets. I was frightened by the efforts to increase my already oppressive tax load, and calls for the creation of vast new bureaucracies. And, nearly every day, I was shocked by the indifference of my neighbors to the tightening controls on their lives. As I turned off the TV it seemed the topic being discussed was trivial compared to some things—yet I couldn't stop wondering at my own apathy.

As I lay in the dark, an odd, out-of-place memory came to mind. I recalled the two years I had lived in Europe. It occurred to me that I could remember almost nothing of the events that had gone on around me at the time. The reason for this was fairly obvious. While I had been *in* Europe, I had not been *of* Europe. To me, "the world" had been America, several thousand miles away. I had felt as removed from the culture around me as I would have been were I observing a tribe of aborigines. European affairs had aroused not the slightest emotion in me.

My mind went off on other strange tangents. I thought of my grandfather, who had come to America at the turn of the century, leaving a comparatively prosperous life in Europe to live in a strange land where he couldn't speak the language, and had to work as a common laborer. Despite stories of oppression by the czar's armies, it was never clear to me why he had thrown up his hands and given up on his native country, when thousands of others, including his own brother, chose to remain.

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When and why had the idea to leave first played across his mind, and what was he feeling when the idea became a decision?

My thoughts turned to John Steinbeck's novel, *The Grapes of Wrath*, about the desperate flight of the Okies from the dust bowl of the Midwest to seek work in California. Several times in the book Steinbeck wrote that, when the migrant men got mad, their women felt relieved, because they knew that men who still could get mad, and shout, and curse had not reached a breaking point.

I wondered—was my current, momentary apathy a passing mood, or was it a symptom that, in my heart, I was giving up on America? Did I now feel as alienated from my neighbors as I once had from the Germans who had bustled about me on the streets of Frankfurt? I had daydreamed about expanding my business to some emerging country, but had passed the idea off as merely a mid-life adventure fantasy—was I actually repeating a thought process that had brought my grandfather to abandon his roots, ninety years before?

As I drifted off to sleep, I reflected that men will get mad, and shout, and curse—even at television sets—when they see hope being stolen from them. It's when they think that all hope for the future is gone that they fall silent, and no one can be sure what they'll do then. □

IDEAS ON LIBERTY

Rights for Robots

Millions of our people now look to the government much in the same fashion that their fathers of Victorian times looked to God. Political authority has taken the place of heavenly guidance.

Herbert Spencer in that wonderful prophecy, *The Man Versus the State,* explained in detail what would happen. He foretold with exactitude the present rush of the weaklings for jobs as planners and permitters, telling other people what *not* to do.

You will have noticed that while we are all under the thumb of authority, authority becomes composed of those who, lacking the courage to stand on their own feet and accept their share of personal responsibility, seek the safety of official positions where they escape the consequences of error and failure. Active, energetic, and progressive persons, instead of leading the rest, are allowed to move only by the grace and favor of that section of the population which from its very nature lacks all the qualities needed to produce the desired results. Authority is the power to say *no,* which requires little or no ability.

On a broad view, the all-important issue in the world today is *individualism* versus *collectivism.*

The Individualist thinks of millions of single human souls, each with a spark of divine genius, and visualizes that genius applied to the solution of his own problems. His conception is infinitely higher than that of the politician or planner who at best regards these millions as material for social or political experiment or, at worst, cannon fodder.

—SIR ERNEST BENN

Mandated Benefits: The Firm as Social Agent of the State

by Richard B. McKenzie

There is a growing movement in Congress to force businesses into providing a wide range of employee benefits. These benefits include mandated health insurance for employees and dependents, life insurance, parental leave, day care, a higher minimum wage, employee consultation rights on pension investments, severance pay, retraining, and pre-notification of plant closings. The key word here is "mandated"—all these benefits would be required by law.

The current interest in mandated benefits appears to stem from three main sources. The first is statistical. Numerous studies have uncovered gross inefficiencies in government delivery systems, compared with the private sector. Surveys also have shown that many American workers receive substantial employment benefits, while other workers receive few such benefits. Similarly, a string of reports has indicated that many employees are not provided with "adequate" notice of the closing of their plants.

Proponents seem to think that if these benefits are not voluntarily provided by employers, then they should be mandated by government. They also seem to think that mandated benefits will improve the welfare of workers.

The second reason for the movement toward mandated benefits stems from massive Federal deficits, which are limiting Congress' ability to authorize new social programs. Imposing the costs on business, therefore, is an attractive alternative. There is political resistance to raising taxes or even spending more Federal money, but apparently disguising the costs of various social programs by passing them through as higher prices for goods and services is considered to be more politically palatable.

Somewhat ironically, the third source of interest in mandated benefits is a strange twist to the case for privatization: if it is a good idea to privatize some governmental operations to make them more efficient, then making the firm the delivery agent for social services should improve the efficiency and quality of social programs.

Advocates of these programs also argue in terms of social costs. Plant closings, for instance, create problems for local communities. By making firms social agents of the state, firm managers will have to consider these outside costs.

Mandated worker benefits are not new. Mandated money benefits, commonly called the minimum wage, appeared in the 1930s. What we now are seeing is an extension of the rationale behind minimum wages to a wide variety of employment benefits.

What supporters of mandated benefits fail to see is that workers are paid not simply in terms of so much money per hour, but in terms of "payment bundles" that include money wages as well as nonmonetary benefits such as health

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and life insurance, vacation time, rest periods, subsidized lunches, child care, severance pay, and working conditions. Workers strive to maximize their payment bundles—as they themselves evaluate them—and not just their monetary incomes.

At any given level of worker productivity, payment bundles cannot exceed an amount which, over time, will cause the firm to break even—otherwise the firm will close. Thus, new legislation requiring employers to include specific wage or fringe benefits in their payment bundles effectively requires employers to withdraw other benefits that are not required, or to make their employees work harder to offset the greater costs of the mandated benefits.

Mandated benefits can cause the value of the payment bundles as judged by employees (not by Congress) to fall. Workers, after all, can negotiate the inclusion of fringe benefits in their payment bundles, in return for forgoing higher wages or other benefits. When such trades are not made in worker contracts, it must be presumed that a sizable percentage of the covered workers prefer not to make such trades.

Assessing the Loss to Workers

The loss to workers because of mandated benefits also can be assessed from the impact of these benefits on employment opportunities. Obviously, those workers who remain unemployed because of the added employment costs of mandated benefits are worse off because of the government action.

Not so obviously, even the workers who retain their jobs can be worse off—to the extent that the value of their payment bundles decreases. The value of their payment bundles can be expected to fall primarily because the reduced demand for workers—due to mandated benefits—means that their bargaining positions will be impaired. The number of jobs can be expected to fall because the increase in the costs of hiring labor will tend to be reflected in higher prices and lower sales. As a consequence, fewer workers will be needed. Another point should be mentioned: the costs of mandated benefits will not be incurred when foreign workers or labor-saving equipment are used.

Consider, as a special case, plant-closing restrictions. The restrictions are a fringe benefit that carries costs in terms of reduced managerial flexibility, diminished access to investment capital (which will shy away from affected firms), and the potential loss of business once a closing has been announced. Such restrictions, as with all other mandated benefits, add to the costs of doing business in the affected region, and therefore discourage firms from opening plants. The closing restrictions may save some jobs for a time, but they also tend to reduce business investment and decrease the number of new jobs. Plant-closing restrictions can encourage firms to open their plants in foreign countries and to substitute, where feasible, machines for workers.

Of course, many firms do give notice of pending plant closings, offer severance pay, and consult with their workers concerning alternatives to closings. However, production circumstances differ and workers vary in terms of their preferred payment bundles. Many of the firms that have given a substantial notice did so because of a negotiated agreement under which workers gave up something in the form of wages or other benefits in order to receive the notice. The fact that many firms did not give notice—and did not violate a contract in the process—indicates that many workers felt, at the time of the contract, that the notice was not worth the attendant sacrifice.

Mandated benefits are especially troublesome when, in practice, they don't apply equally to all workers. Such laws make employment of the covered workers relatively more expensive, compared with other workers and compared with the costs of machinery. Parental-leave laws will tend to raise the costs of hiring workers in their child-bearing years, especially women workers. Catastrophic-health-insurance requirements will tend to raise the costs of hiring older workers. Laws that require firms to continue the medical coverage of their workers when they are laid off or terminated will tend to raise the costs of hiring workers in unstable or high-risk jobs.

In addition, mandated benefits don't apply equally to all firms. Those firms that have

fringe benefits which exceed the mandated benefits will not be directly affected by the mandates. However, they can be indirectly affected—to their benefit. In the case of minimum wages, firms facing competition from low-wage firms often have a private stake in minimum wages because such legislation snuffs out existing and potential competition. Similarly, firms facing competition from "low fringe-benefit" firms have a private interest in mandated benefits, since such benefits harm their competitors.

Practically everyone engaged in the debate over mandated benefits would prefer that all workers have higher wages and more benefits. This is especially true when we address the problems of low-income Americans. However, the main problem of low-income workers is a lack of job skills, which leaves them little choice but to accept low wages and low benefits. Mandated benefits will do nothing to solve the problems of these workers. Indeed, by wiping out employment opportunities, mandated benefits are counterproductive, especially for the most disadvantaged in labor markets. Mandated benefits will not supplant the welfare state; mandated benefits, instead, will hasten the growth of an even larger welfare state—to take care of those banished from constructive employment. □

Bumper-Sticker Economics

by Cecil E. Bohanon and T. Norman Van Cott

Economics is alive but not well on America's highways. Americans are continually instructed in the nuances of economics via a plethora of bumper stickers of questionable content. Some mobile placards thinly veil people's attempts to increase their incomes by duping others. The United Auto Workers' ludicrous claim that buying a foreign car dooms ten assembly-line workers to a lifetime of unemployment is such a sticker. Other drivers carry the torch for causes ranging all the way from the National Rifle Association's "God, guts, and guns" theory of American economic development to left-liberal pleas to produce food "for people, not for profit."

In this wasteland of economic illiteracy, we have found one sticker that offers more than mere comic relief. America's truck owners, no doubt tired of hearing that their trucks mangle the roads, have retaliated with stickers stating, "This Truck Pays Umpteen Thousand Dollars in Annual Road-Use Taxes." Contrary to others, there is a seed of economic truth in this sticker. The message describes the user-cost mechanism in U.S. highway finance, however imperfect the mechanism may be.

At the same time, this back-of-the-truck tax return illustrates a widespread myth about

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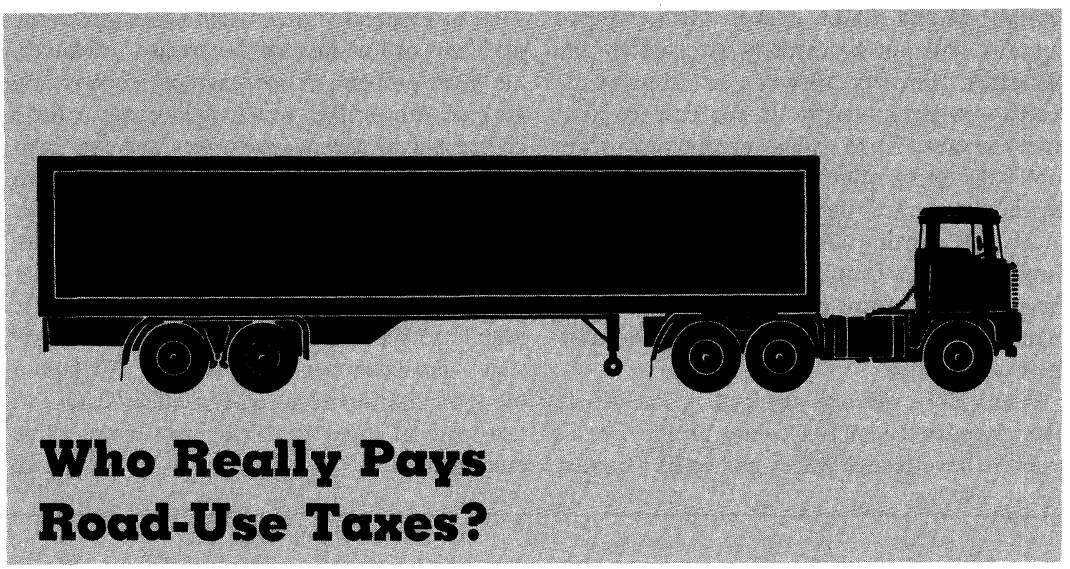

taxes—a myth that is responsible in part for the sorry condition of public discussion of tax policy. Let us sketch this myth, using as a backdrop the American truckers' attempt at economic education.

The Myth

The myth is that inanimate objects—like trucks—pay taxes. The truth, of course, is that inanimate objects never pay taxes, only *people* pay taxes. We enjoy pointing out to our students that when we pay our car license fees at the motor vehicles office, we never wait in line behind trucks. We wait behind *people* who own trucks. People pay every tax—be it a truck tax, land tax, corporate profit tax, wealth tax, or any other business tax.

One might think that we are belaboring the obvious, if not being simplistic, to point out that only people pay taxes. Note, however, that politicians across the political spectrum continually draw a distinction between taxes levied "on the people" and taxes levied "on business." The distinction is utterly fallacious. The people who own businesses are legally responsible to pay business taxes.

Nevertheless, politicians of all stripes find it appealing to perpetuate the "people vs. business" tax illusion. By convincing the electorate that people escape "business taxes," it is easier to increase these taxes. Politicians, thereby armed with additional tax revenue, can sell classic "free lunches"—new government programs that no one seems to pay for.

A variant of this myth is that the legal responsibility for paying taxes is the same as the economic responsibility. Tax laws specify who is *legally* responsible for remitting tax revenues to the government. However, just because truck owners are legally responsible for paying road-use taxes does not mean they are the ones who actually pay them.

Road-use taxes increase costs for trucking companies, and these costs tend to translate into higher freight rates. This means that consumers of trucking services "share" in the burden of the tax. Likewise, to the extent road-use taxes negatively impact on the size of the trucking industry, truck drivers and truck manufacturers "participate" in the tax through lower earnings. The precise apportionment of the tax depends on what economists call the supply-demand conditions of the industry, but what is obvious is that actual tax burdens can be very different from legal tax burdens.

Conclusion

Truck owners can help demythologize taxation while still venting their anger. May we suggest a sticker along the following lines: "Look Straight into Your Rear-View Mirror, Buddy, and You'll See Who's Really Paying Some of the Umpteen Thousand Dollars This Truck Owner Pays in Road-Use Taxes." □

The Political Economy of Protectionism

by Thomas J. DiLorenzo

Disagreements among economists are legendary, but they are largely of one mind on the issue of free trade. Evidence of this is a recent survey of the current and past presidents of the American Economic Association—the voice of mainstream economics. The survey found these prominent economists all strongly in favor of free trade, and concluded that "an economist who argues for restricting trade is almost as common today as a physician who favors leeching patients."[1]

Mainstream economic thinking on free trade knows no ideological boundaries. Conservative economists Milton and Rose Friedman, for example, write that "ever since Adam Smith there has been virtual unanimity among economists . . . that international free trade is in the best interest of the trading countries and the world."[2] Liberal economist Paul Samuelson concurs: "Free trade promotes a mutually profitable regional division of labor, greatly enhances the potential real national product of all nations, and makes possible higher standards of living all over the globe."[3]

The case for free trade is not based on any stylized economic theories of "perfect competition," "general equilibrium," or "partial equilibrium." After all, Adam Smith is history's most forceful and articulate defender of free trade, and he never heard of any of those theories. Rather, the case for free trade is based on the virtues of voluntary exchange, the division of labor, and individual freedom.

As long as trade is voluntary, both trading partners unequivocally benefit; otherwise they wouldn't trade. The purchase of a shirt, for instance, demonstrates that the purchaser values the shirt more than the money spent on it. The seller, on the other hand, values the money more than the shirt. Thus, both are better off because of the sale. Moreover, it doesn't matter whether the shirt salesman is from the United States or Hong Kong (or anywhere else). Voluntary exchange is always mutually beneficial.

Free trade expands consumer choice and gives businesses incentives to improve product quality and to cut costs. By increasing the supply of goods, international competition helps hold down prices and restrains internal monopolies. The "Big Three" auto makers, for instance, may *wish* to monopolize the automobile market, but they are unable to because of foreign competition. About 75 per cent of all domestic manufacturing industries now face some international competition, which helps keep their competitive feet to the fire. Thus, the case for free trade is the case for competition, higher quality goods, economic growth, and lower prices. By contrast, the case for protectionism is the case for monopoly, lower quality goods, economic stagnation, and higher prices.

The costs of protectionism to consumers are

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enormous. According to very conservative estimates, protectionism costs American consumers over $60 billion per year—more than $1,000 annually for a family of four.[4] Thanks to protectionism, for example, it costs about $2,500 more to buy a Japanese-made car than it otherwise would.

Free trade increases the wealth (and employment opportunities) of all nations by allowing them to capitalize on their comparative advantages in production. For example, the U.S. has a comparative advantage in the production of food because of its vast, fertile land and superior agricultural technology and labor. Saudi Arabia, on the other hand, does not have land that is well suited to agriculture. Although Saudi Arabia conceivably could undertake massive irrigation to become self-sufficient in food production, it is more economical for the Saudis to sell what they *do* have a comparative advantage in—oil—and then purchase much of their food from the U.S. and elsewhere. Similarly, the U.S. could become self-sufficient in petroleum by squeezing more oil out of shale rock and tar sands. But that would be much more costly than if the U.S. continued to purchase some of its oil from Saudi Arabia and elsewhere. Trade between the U.S. and Saudi Arabia, or any other two countries, improves the standard of living in each.

Ethical Aspects of Free Trade

Protectionism is not only economically inefficient, it is also inherently unjust. It is the equivalent of a regressive tax, placing the heaviest burden on those who can least afford it. For example, because of import restraints in the footwear industry, shoes are more expensive. This imposes a proportionately larger burden on the family that has an income of only $15,000 per year than on the family that has an income of, say, $75,000 per year. Moreover, the beneficiaries of protectionism are often more affluent than those who bear the costs. Wages in the heavily protected auto industry are about 80 per cent higher than the average wage in U.S. manufacturing. The Chairman of the Chrysler Corporation was paid $28 million in 1987, thanks partly to protectionism. And, perversely, by driving up the price of automobiles, protectionism has benefited the owners, managers, and workers of the *Japanese* automobile industry at the expense of American consumers. Protectionism, in other words, is welfare for the well-to-do.

Protectionism also conflicts with the humanitarian goals of foreign development aid. The U.S. government spends billions of dollars annually in foreign aid to developing countries. Many of these programs are themselves counterproductive because they simply subsidize governmental bureaucracies in the recipient countries. But what good does it do to try to assist these countries if we block them from the biggest market in the world for their goods? Protectionism stifles economic growth in the developing countries, leaving them even more dependent upon U.S. government handouts.

Why Protectionism?

Despite the powerful case for free trade, both the United States and the rest of the world are highly protectionist, and always have been. This is because free trade benefits the general public, whereas protectionism benefits a relatively small group of special interests. The general public is neither well organized nor well informed politically, but the special interests are. This political imbalance was recognized by Adam Smith over 200 years ago when he wrote in *The Wealth of Nations* that

> To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it. . . . The member of parliament who supports every proposal for strengthening this monopoly, is sure to acquire not only the reputation of understanding trade, but great popularity and influence with an order of men whose numbers and wealth render them of great importance. If he opposes them, on the contrary, and still more if he has authority enough to be able to thwart them, neither the most acknowledged probity, nor the highest rank, nor the greatest

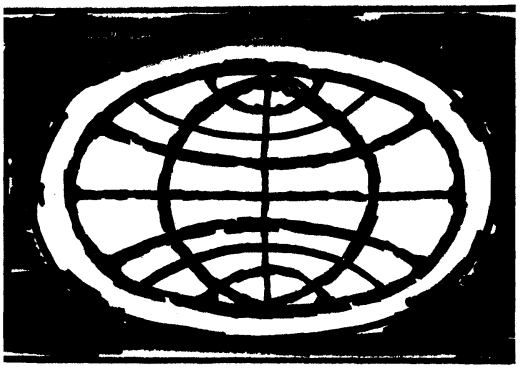
> public services can protect him from the most infamous abuse and detraction, from personal insults, nor sometimes from real danger, arising from the insolent outrage of furious and disappointed monopolists.[5]

The political pressures to grant monopolistic privileges are so strong that even political figures who spend their careers speaking in favor of free trade quickly cave in to protectionist pressures once in office. U.S. Treasury Secretary James Baker recently boasted, for example, that "President Reagan has granted more import relief to U.S. industry than any of his predecessors in more than half a century."[6] Unfortunately, the Democratic party is not very different. "There is no strong supporter of a free and open trading system," complained Hobart Rowan of the *Washington Post,* "among the seven declared Democratic [Presidential] candidates."[7]

Voters might be expected to oppose policies that stifle economic growth and redistribute income from poor to rich. But public opposition to protectionism is not very strong, explains economist Mancur Olson, because "the typical citizen is usually 'rationally ignorant' about public affairs."[8] That is, the typical citizen spends most of his or her time worrying about personal matters and not economic policy. To add to the confusion, much of the information that citizens do receive about public policy is self-serving and biased information disseminated by special-interest lobbyists. As economist Gordon Tullock has written:

> Special interest groups normally have an interest in diminishing the information of the average voter. If they can sell him some false tale which supports their particular effort to rob the treasury, it pays. They have resources and normally make efforts to produce this kind of misinformation. But that would not work if the voter had a strong motive to learn the truth.[9]

For decades monopolists and potential monopolists have crafted hundreds of myths about free trade and protectionism. The following are just a few examples of misinformation about protectionism.



Protectionist Myths

Myth #1: *Imports (and trade deficits) are bad; exports (and trade surpluses) are good.*

The international trade deficit has been of concern to Congress in recent years, and has been a primary "justification" for protection. But the notion that importing more than we export is necessarily bad ignores some elementary economic principles. First, imports are our *gain* from trade. The more material goods—the more trade—the better. Remember, *all* trade is mutually beneficial.

How trade-deficit statistics can give misleading impressions of economic health is illustrated by the analogy between domestic and international trade. Most citizens probably run a trade deficit with their grocers. But who would argue that a balance of trade between consumers and grocers is necessarily desirable? A government-mandated trade balance—whether for domestic or international trade—would make both trading partners worse off. Furthermore, the notion that, say, Taiwan, with a population of 20 million, should buy as many goods from the U.S. as 230 million American consumers purchase from Taiwan is absurd. The balance of trade argument is just another weak excuse for monopolistic trade restrictions.

Myth #2: *Being a "debtor nation" is economically harmful.*

Being a debtor nation means that foreigners invest more in the U.S. than U.S. citizens invest abroad. Debtor nation status is not necessarily a cause for alarm, however, since foreign investment in the U.S. can be beneficial. For example, there are many obvious benefits from

Tennessee's new Nissan plant and the 50 other Japanese companies located in that state. These new companies provide jobs, make American industry more competitive, and stimulate economic growth. The U.S. has been a debtor nation throughout most of its history, including the period from 1787 to 1920, when the nation experienced the most rapid economic growth in world history up to that time.

Alarm over becoming a debtor nation is illogical and contradictory. On the one hand, protectionists complain that too much money is leaving the country (we're importing more than we're exporting). Then, when the same money returns to the U.S. in the form of foreign investment, they complain that too much money is coming *into* the country. The protectionists cannot have it both ways. They are grasping at straws to justify monopolistic privileges.

Myth #3: *Imports are destroying American jobs.*

Like all long-lasting myths, this one has a grain of truth. If more American consumers buy Japanese rather than American-made cars, it may threaten some American jobs. Efforts should be (and are) made to ease the transition of those who become temporarily unemployed, but protectionism would only cause even more unemployment.

Free trade *creates* jobs by reducing prices, leaving more money in the pockets of consumers. Increased consumer spending in turn will stimulate production *and employment* throughout the economy. By contrast, higher prices in a protected industry will cause consumers to cut back on their purchases, which will result in *less* employment in that industry.

Also, the dollars that Americans pay for foreign-made goods eventually are respent in the U.S., which creates even more jobs. Foreigners have no use for dollars per se. They must either spend them in the U.S. or sell them to someone who will.

Protectionism may *temporarily* "save" jobs in one industry, but it usually destroys even more jobs elsewhere. For example, because of protectionism in the steel industry, American automakers are estimated to pay as much as $500 more per car for steel than Japanese automakers. Higher prices for American-made cars will cost domestic automakers business and cause them to lay off workers. Thus, protectionism in the steel industry creates unemployment in steel-using industries.

It is particularly telling that in recent years, as the trade deficit has grown, so has employment in the U.S. economy. More than 13 million new jobs were created between 1982 and 1988 as the unemployment rate dropped from nearly 11 per cent to less than 6 per cent of the labor force. In contrast, we had a trade *surplus* throughout the 1970s when unemployment rose steadily.

Myth #4: *Because of international competition, the U.S. manufacturing sector is declining.*

Protectionists have claimed that the U.S. economy is "deindustrializing" because of the alleged failure of American manufacturers to compete on international markets. But the deindustrialization theory is a hoax. Manufacturing output as a percentage of GNP is about 24 per cent today, compared to 25 per cent in 1950.[10] Moreover, manufacturing output *and employment* are at their highest levels ever. The *composition* of employment and output has changed, as it always does in a dynamic, growing economy. Economic growth always creates many dislocations. Overall, however, the U.S. manufacturing sector is not "deindustrializing."

Myth #5: *Because of international competition, many newly-created jobs are low-paying, "dead-end" jobs.*

A Congressman recently claimed that "50 per cent of the 13 million new jobs [created between 1982 and 1987] are dead-end—paying $7,400 a year or less. We're trading good manufacturing jobs for low-pay service jobs."[11] The Congressman asserted that international trade is "impoverishing America," and has introduced protectionist legislation to thwart this perceived trend.

The U.S. Department of Labor recently examined these claims in great detail and found the reality to be much different from the Congressman's rhetoric. Of the 13 million new jobs created between 1982 and 1987, 59 per cent were in the *highest-wage* category as classified by the Labor Department. Only 7 per cent of

the new jobs were minimum-wage jobs paying $7,400 per year or less.[12]

Myth #6: *Cheap foreign labor is an unfair advantage.*

It is often said that if, say, textile workers in Singapore are paid only $1 per hour, American industry cannot possibly compete, given that American textile workers are paid more than $10 per hour. Protection is supposedly needed if the domestic textile industry is to survive.

This argument may appear compelling at first, but it ignores several important facts. First, if the productivity of American workers is ten times as high as in Singapore (because of superior capital, technology, and training), then higher American wages are not a disadvantage.

Second, the idea that low wages "explain" international trade patterns is illogical. If it were true, the U.S. would export almost nothing, since U.S. wages are higher than almost everywhere else in the world across the board. What determines a nation's comparative advantage in international trade is the *total* amount of resources it must use to produce a given product, not just the labor. Many low-wage countries import U.S. goods because we have a comparative advantage in producing those goods despite our higher wages. Moreover, low-wage countries *must* eventually import goods from the U.S. because there is nothing else they can do with the dollars they receive from their American sales.

Finally, it isn't clear why it is "unfair" for American consumers to enjoy lower-priced and/or higher-quality goods produced overseas by low-wage (or other) countries.

Myth #7: *Protection is necessary to counteract "dumping."*

So-called dumping occurs when foreign manufacturers sell products in the U.S. that supposedly are priced below the price at which they are sold in the home market. There are numerous laws that prohibit dumping on the grounds that it is unfair competition.

But there are also sound economic reasons for such business practices. Temporarily charging prices that are below cost is a common *competitive* business practice. For example, newly-established pizza parlors typically offer "two for the price of one" specials as an inducement to consumers to try out their product. The losses incurred during the sales are considered an investment that will yield future sales by generating a clientele. Lower prices always benefit consumers, but we seldom charge the local pizza parlor with "dumping." Perhaps this is because consumers can plainly see the benefits of such competition.

In November 1987, the U.S. Commerce Department ruled that "Japanese companies violated international trade laws by failing to increase their prices to match the sharp rise in the value of the yen."[13] With the rise in the value of the yen, Japanese goods sold in the U.S. became relatively more expensive. The Japanese producers responded by cutting their costs, prices, and profit margins to remain competitive, to the great satisfaction of American consumers. According to the Commerce Department, Japanese export prices declined by 23 per cent between 1985 and 1987. Unfortunately, the protectionist Reagan administration is opposed to such price cutting.

Dumping is often said to occur because foreign governments subsidize some of their manufacturers, which allows the companies to underprice American firms. These policies may be misguided, but there is no reason why American consumers should be punished for the short-sighted policies of foreign governments. Such subsidies constitute a "gift" from foreign taxpayers to American consumers and may be thought of as foreign aid in reverse. Moreover, the extent to which this subsidization takes place has been greatly exaggerated. In Japan, for instance, the amount of assistance given to Japanese manufacturers by the Japan Development Bank has amounted to less than one per cent of gross domestic investment, and most of that has gone into the agricultural sector.

Dumping is also objected to on the grounds that it is a means of monopolizing American industries by driving out the competition with low prices. There have been no documented examples of such monopolization, however, and for good reason. Any manufacturer who charged monopolistic prices would face fierce international (and domestic) competition that

would quickly dissipate any monopoly power. Businesses that charge their international competitors with dumping are simply unwilling to charge prices that are as low as their rivals'.

Myth #8: *Temporary protection is needed to "buy time" and adjust to the competition.*

Temporary trade relief is like being a little bit pregnant. The textile industry, for example, was given "temporary" trade relief 25 years ago and is still being "relieved." This rationale admits that protectionism is a bad idea, which is why it is labeled as only temporary. However, it is bound to make things worse for the industry, not better.

By reducing competitive pressures, protectionism tends to stifle innovation. Businesses are less prone to invest in engineering and technology when profits can be earned just as easily by lobbying for protection.

There is much evidence, moreover, that "temporary" protection does not revitalize industries, and probably is even counterproductive. The federal government's Congressional Budget Office studied protectionism in the textile, steel, footwear, and automobile industries, and concluded that "in none of the cases studied did protection . . . revitalize the affected industry. . . . Protection has not substantially improved the ability of domestic firms to compete with foreign producers."[14] The study showed that investment often *declines* during periods of protection, which causes the protected industries to fall even farther behind the competition. Such evidence explains why a closely related protectionist argument—the military might argument—is also fiction. Specifically, if an industry is important to national defense, it supposedly should be protected from international competition. But since protection saps incentives for innovation, resulting in lower-quality and higher-priced goods, it will *weaken* the national defense by weakening industries that the military relies upon.

Myth #9: *We should restore a "level playing field" by erecting trade barriers against countries that have trade barriers against us.*

This is a "cutting off our nose to spite our face" strategy. If foreign governments are foolish enough to harm their own citizens by erecting trade barriers, it is unfortunate for those citizens. But there are no sound reasons why American consumers should be penalized for the ill-conceived trade policies of foreign governments.

Furthermore, trade retaliation would be hypocritical, since American trade restrictions on foreign imports are often much greater than foreign restrictions on American imports. The American auto parts supply industry, for example, is currently lobbying for protection on the grounds of "unfair competition" from Japanese auto parts suppliers. The hypocrisy of this claim stems from the fact that there are no Japanese government-imposed barriers to importing American auto parts into Japan, but Japanese parts producers must pay American tariffs when exporting to the U.S.

Trade retaliation can be a very dangerous political game. The Smoot-Hawley tariff of 1930 spawned an international trade war that helped precipitate the Great Depression. Dozens of countries responded to the Smoot-Hawley tariff by erecting trade barriers for American-made goods. Consequently, the value of imports in the 75 most active trading countries fell from over $3 billion in 1929 to about $1 billion by 1932, driving the world economy into a depression.[15]

Trade retaliation is inherently counterproductive. By reducing the flow of dollars from the U.S., foreigners will have fewer dollars to spend in the U.S., which eventually will harm American export industries. American exports generally fall once imports are reduced. Consequently, employment in export-related industries, which account for as much as one-fifth of all employment in the U.S., will fall.[16]

Myth #10: *Protectionism benefits union members.*

This is probably true in the short run, but certainly not in the long run. Because of protectionism in such industries as steel, automobiles, textiles, and footwear, unions once prospered by imposing featherbedding rules and by bargaining for supra-competitive wages. As long as international competition was not very effective, raising wages while reducing productivity was feasible. However, international

competition eventually seeped in, as it inevitably does, and American industries found themselves at a severe competitive disadvantage. They lost market share, laid off thousands of workers, and union membership declined dramatically. Thus, protectionism may have helped unions in the short run, but is a main cause of their current malaise. It is no coincidence that some of America's most lethargic unionized industries—steel, automobiles, footwear, rubber, textiles—are also among the most heavily protected.

Conclusions

In sum, a dynamic economy is essential for economic growth and job creation, and protectionism only hinders the necessary adaptations to economic change. As Nobel Laureate Friedrich Hayek has written, the benefits of competition and economic growth

> are the results of such changes, and will be maintained only if the changes are allowed to continue. But every change of this kind will hurt some organized interests; and the preservation of the market order will therefore depend on those interests not being able to prevent what they dislike. . . . this general interest will be satisfied only if the principle is recognized that each has to submit to changes when circumstances nobody can control determine that he is the one who is placed under such a necessity.[17]

Protectionism may provide some short-term benefits to a small number of special interests, but at much greater costs to the rest of society. Restraints on international trade are inefficient, inequitable, and counterproductive, and should not be imposed. □

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IDEAS ON LIBERTY

Barriers to Trade

Any barrier placed in the way of foreign trade reduces living standards because it reduces the advantages that can be gained from the greater international division of labor, whereby goods are produced by those best able to produce them at the least expense to mankind. Any rise in domestic prices as a result of government intervention also leads to a decrease in foreign trade and the advantages to be gained therefrom. . . . The only true solution to our problems is a world of peaceful free trade with political privileges for none. Every step in that direction is an improvement. Every new intervention makes matters worse.

—PERCY L. GREAVES, JR.

The Burden of Bureaucracy

by M. E. Bradford

If anything endures in our political life it is the bureaucracy. Administrations come and go, but the bureaucracy is forever—or so it seems; and it not only endures, it grows and grows in the direction of a total politicization of every aspect of our existence. If we would have once again a free society, it will require of us a heroic effort, not just in electing a President and Congress with whom we can expect to agree but also in waging war "in the trenches of day-to-day definition of public and private policy, separating legitimate and appropriate government action from the usurpations and abuses which must be eliminated," as George Roche has argued.

The first stage in escaping from the toils of bureaucracy is to learn once and for all that the cost of state action in relieving the announced unhappiness of any component part of society may be, if not authorized by the Constitution as it stood before 1860, a further step toward subservience and degradation for all—including members of the aggrieved group in whose name the action is performed. For the only government that can answer to every claim of injured merit put forward by a component of the population it regulates and thus defines is a government with an absolute authority over every person under its sway. Said another way, the only government that can secure to us all of the "rights" (read "privileges") we might hope to enjoy is a government which can just as easily leave us with no freedom of any kind. Either way bureaucracy will be involved. For the end result of every new addition to the machinery of the state, each of its new bureaus and investigative or regulatory agencies, whatever the ostensible reason for their creation, is to increase statist regimentation and diminish individual initiative: no more and no less.

Bureaucracy is essentially military in its character, needing an "army" to carry out its collective will. It is the routine (as opposed to the exceptional) power of the state in its coercive mode. It is wholly political in its nature and thus exists primarily to augment the scope of government. And it never surrenders any ground it has gained, never gives up voluntarily any function once assigned to it.

In our time we have learned that it is impossible to exaggerate the tenacity of bureaucracy, once established and in place. Seven years of the Reagan Administration—a regime called into office *because* it promised an end to repressive regulation—provide additional evidence of the persistence of an established bureaucracy. Even with massive support at the polls and a national consensus that we are over-

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governed, the first officially conservative, anti-bureaucratic government in fifty years is unable to counter the cause-and-purpose-oriented rhetoric used to defend the edifice it promised to reduce. We have not yet generated the strength of will to be done with the parasite—a curious development in a country born out of a determination to be free from the official benevolence of a remote, arbitrary, unresponsive, and often hostile authority.

George Roche, writing in the tradition of Ludwig von Mises' *Bureaucracy,* produces a potent little study called *America by the Throat* (Devin-Adair, 1983). He tells us that bureaucracy costs our citizens (apart from military spending) about $3,000 apiece each year. Furthermore, he expects worse, and propounds a first and second law of bureaucracy. The first is: "the supply of human misery will rise to meet demand." The principle involved has to do with felt need and signifies that the impulse to "correct" society in some particular is antecedent to the problem on which bureaucracy focuses in the end. The second law is equally simple: "the size of bureaucracy increases in direct proportion to the additional misery it creates." In other words, bureaucracy grows by feeding on its own failure to be instrumental in any practical sense.

It is a warning to the bureaucrats and their legislating friends that not everyone has been lulled asleep by the idea that, after 1980 and 1984, the day of regimentation is over. Wishing will not make it so. For freedom is always both difficult and expensive. Submission seems more convenient, at least until we know it by experience and are frightened into such resistance as should have been our practice from the beginning. □

Hong Kong Reflections

by Michael Walker

The citizens of Hong Kong have expressed a great deal of concern about what will happen once the tiny British colony falls under the control of the People's Republic of China in 1997. As I discovered during a recent visit to Hong Kong, the fear is not that the Chinese have malicious intentions, but that they will not know how to manage Hong Kong's affairs so as to avoid interfering with its highly successful economy.

For one thing, despite recent moves toward openness and more freedom in China, deeply conservative forces within the bureaucratic structure are impeding the process. While undoubtedly some of the impediments have been put up by bureaucrats who do not wish to relinquish their power, many of the problems are caused by the fact that Chinese bureaucrats simply do not know how to encourage and assist the economic process—how to practice laissez faire. They do not yet know how to be creatively inactive.

The consequence is that on the Chinese side of the border the average income is $250 per year whereas on the Hong Kong side it is $8,000. It is not surprising that the residents of Hong Kong look upon the prospect of more "help" from China with some dismay. But they are even more concerned about their civil freedoms.

Hong Kong has enjoyed a large measure of freedom of the press, freedom to own or lease property, freedom of travel and communication, and so on, despite its lack of political freedom. Its government is appointed by the British, and there are no real elections, although there is now a council with representatives from sectional and professional groups.

The impending replacement of the British as the dominant outside force already has begun to

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BETTINA BIEN GREAVES

Hong Kong Harbor.

have its effects. Hong Kong is beginning to transform itself into a colony of China and is shedding British colonial attitudes. This is evident in the travel patterns of business people, scholars, and officials who instead of going to London increasingly are Beijing bound. It is also evident in the increasing guardedness of those who make public statements and who have a public profile in institutions that will remain when the British Governor leaves.

With few exceptions, people who speak out try to avoid irritating Chinese officials. Accordingly, while there is no censorship, there is increasing conformity to the Chinese line. It is easy to understand why this is so. The citizens of Hong Kong will not be able to vote with their feet if they do not wish to remain when British colonial status ends in 1997. Most do not have citizenship in other countries nor can they expect easily to obtain it.

While Chinese officials have assured the people of Hong Kong that the existing laws, regulations, and freedoms will be retained under the new regime, one does not have to dig far into the existing structure to find some very disconcerting things. For example, there are laws which provide for censorship of the press in the event of a serious threat to the colony. In the hands of the existing administration, monitored at a distance by the British Parliament, this has meant no censorship in practice. Under the administration of a Chinese bureaucracy which has known only censorship, quite another situation is probable. The same is true of other seemingly innocent laws and regulations which in different application could produce a radically altered political and economic climate.

There is hope, however, in that there is a great thirst in China for knowledge about how free enterprise economies operate. One of the most hopeful signs in this regard is the recent birth in Hong Kong of a new institute called The Hong Kong Centre for Economic Research. One of the functions of this new group will be to translate into Chinese and make available to Chinese policy makers and intellectuals books and studies that will show them how a free economy works and what the appropriate role of government is in a free society. In the end, of course, it is ideas that will determine the fate of Hong Kong and China. □

Government Regulation of Business: The Moral Arguments

by Tibor R. Machan

Throughout the world, governments engage in social and economic regulation of their citizens' lives. Economic regulation, in particular, has come into focus during the past decade, mainly because such regulation has been associated with falling productivity rates in many industrialized countries. But social regulation by government also is being discussed when drug abuse legislation, censorship of pornography, and similar matters are considered.

Most types of government regulation involve the setting up and enforcement of standards for conducting legitimate activities. My concern here is with government regulation of business or economic affairs by municipal, county, state, and Federal politicians and bureaucrats.

During the past few years, the case for such regulation has been spelled out in fairly clear and general terms. I wish to examine the arguments which are based on moral considerations, since it is such arguments that matter in the defense of the authority of the state to treat its citizens in various ways.

Government regulation differs from government management. Management involves the administration of the properties and realms which the government owns. For example, the national parks and forests are managed by government, not regulated. So is the interstate highway system. In contrast, toy manufacturing, which is an activity of private business, is regulated by government, as are the manufacture and sale of many foods and drugs, the production of cars, and the practice of law, medicine, and other occupations.

There are some gray areas, to be sure. The government regulates broadcasting, but it also manages the airwaves. The electromagnetic spectrum was nationalized in 1927, and the federal government has been leasing out the frequencies which private broadcasters use. So there is a combination of management and regulation which is carried out by the Federal Communications Commission.

In addition, there is government prohibition, mainly in the criminal law, in which some actions are regarded as intrinsically evil, such as murder, theft, embezzlement, and fraud. These activities are forbidden, not regulated, while toy production or mining is regulated, but not forbidden. The writing of novels, news reports, and scientific articles, in turn, is left fairly free of government interference.

But here, too, there are some gray areas, such as the prohibition on the sale of certain drugs over the counter. Nevertheless, for all practical purposes, the three categories are clearly distinguishable—regulation, management, and prohibition.

I will first present the main arguments in

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support of government regulation of business. Then I will consider some responses. (One could ask whether government should manage forests, beaches, parks, or the airwaves, as well as whether there should be any prohibition of any human activity at all, as anarchists might ask, but our concern here is with regulation.)

Creature of the State: This argument for government regulation of business, made prominent by Ralph Nader and others, holds that because corporations are chartered by states, corporate commerce should be regulated. In this view, the state charter actually "creates" the corporation, and government should regulate the behavior of its "dependent," the corporation.

Market Failure: The second moral argument for government regulation of business recognizes that a free market usually enables people to do the best that can be done. On the one hand, free markets encourage maximum efficiency. On the other hand, free markets foster responsible conduct, and encourage the production of goods and services which are of value to members of the community.

But advocates of the "market failure" approach contend that there are some serious exceptions. They assert, following John Stuart Mill, that the free market often fails to achieve maximum efficiency—that it sometimes wastes resources. They often cite the example of utility services. If there were free competition among utilities, "market failure" advocates hold, there would be much duplication—different companies putting up telephone and electric poles, waterlines, etc., side by side, which would be a waste. So it is argued that it is important for government to restrict competition and thus correct market failures.

The second type of market failure, identified by John Kenneth Galbraith in *The Affluent Society*, is that markets misjudge what is important. To wit, markets often don't respond to real needs—for medical care, libraries, safety measures at work, health provisions, fairness in employment and commerce, and so on. Therefore, governments should remedy market failures with regulatory measures. Such measures include zoning ordinances, architectural standards, safety standards, health codes, minimum wage laws, and the whole array of regulations which have as their expressed aim the improvement of society.

Rights Protection: Another "justification" for government regulation of business is the belief that government is established to protect our rights, and that there are many rights which go unprotected in a free market. How do we know there are such rights? Different sources for these rights have been provided in the philosophical community.

Some, for example Alan Gewirth of the University of Chicago, rely on a Kantian deduction of both freedom and welfare rights from the very nature of human action. Some make use of intuitive moral knowledge—e.g., John Rawls of Harvard University and Henry Shue of the University of Maryland. Others, such as Steven Kelman of Harvard University, use a theory of benevolent paternalism. Some thinkers, such as A. I. Melden of the University of California at Irvine, even make use of a revised Lockean approach.

The substantive position of all these philosophers is that employees, for example, are due —as a matter of right—safety protection, social security, health protection, fair wages, and so on. Consumers, no less, should be warned of potential health problems inherent in the goods and services they purchase. In short, these thinkers contend, it is the right of all those who deal on the market to receive such treatment. It should not be left merely to personal caution, consumer watchdog agencies, or the goodwill of traders. Government, having been established to protect our rights, should protect these rights in particular. Thus, it is held, government regulatory activities are the proper means by which this role of government should be carried out.

Judicial Inefficiency: The last argument for regulation that we will consider rests on a belief in the considerable power of the free market to remedy mistakes in most circumstances. But advocates of regulation point to one area where this power seems to be ineffective—pollution. Kenneth J. Arrow of Stanford University has most recently spoken about the need for regula-

tion to overcome judicial inefficiency. His case goes roughly as follows:

Usually one who dumps wastes on the territory or person of another can be sued and fined. Alternately, the permission of the potential victim of such dumping can be obtained, payment for the harm can be made, and so on. But in a wide variety of cases, this is not a simple matter or even possible. Pouring soot into the atmosphere, chemical wastes into lakes, and so forth, may cause harm to victims who cannot be identified. Nor would just a little emission usually cause anyone harm, so it is a matter of the scope and extent of the emission—there is a threshold beyond which emission becomes pollution.

Now since emission into the public realm can involve judicial inefficiency (culprit and victim cannot be brought into contact), when the activity which can lead to public pollution is deemed to be sufficiently important, regulation is said to be appropriate. This general idea derives from the moral viewpoint that some things important to the public at large must be done even if individuals or minorities get hurt. So long as general supervision of such harms is available—so long as cost-benefit analyses guide government regulation—then public pollution is morally permissible.

All these arguments can be elaborated upon, but let us proceed to outline the responses to them that favor deregulation.

In response to the creature of the state case, it is argued, perhaps most notably by Robert Hessen of the Hoover Institution (*In Defense of the Corporation*, Hoover Institution Press, 1979), that corporations did not have to be created by governments and, furthermore, they were so created only because the governments in power at the time were mercantilist states. In the kind of community that sees the individual as a sovereign being, corporate commerce can and does arise through individual initiative. Such commerce is merely an extension of the idea of freedom of association, in this case for purposes of making people economically prosperous.

If the creature of the state argument is a matter of historical accident, the moral case for corporate regulation based on the corporation's dependent status disappears. Corporations are chartered by governments, but that is merely a recording system, not signifying creation. Their legal advantage of limited liability also could be made a contractual provision which those trading with corporations could accept or reject.

As to the market failure of inefficiency, there is the question of whether establishing monopolies, say, in public utilities, really secures efficiency in the long run and at what expense. For example, a strike is more crippling in the case of a public utility than in the case of a firm which doesn't enjoy a legal monopoly. To prevent inefficiency, strikes also must be prohibited. But that, in turn, infringes on the freedom of workers to withhold their services. So the market failure is "remedied" at the expense of a serious loss of freedom. It would be morally better to accept the inefficiencies, given that in any political system it is unreasonable to expect perfect efficiency.

A similar problem arises in the case of "market failure" to produce important, but commercially unfeasible goods and services. Government remedies embody their own share of hazards. Political failures are even more insidious than market failures, as has been amply demonstrated by James Buchanan and his colleagues at the Center for the Study of Public Choice, George Mason University. Bad laws are widespread, and it is difficult to remedy undesirable consequences. Bureaucracies, once established, are virtually impossible to undo. Regulators cannot be sued, so their errors are not open to legal remedy. The market failure case for government regulation, then, seems to fall short of what a defense of this government power requires.

In response to the argument that government regulation of business defends individual rights, we can reply that the doctrine of human rights invoked by defenders of government regulation is very bloated. I myself have argued, e.g., in my "Wronging Rights," *Policy Review* (Summer 1981), and "Should Business be Regulated?" in Tom Regan's *Just Business* (Temple University Press and Random House, 1983), that many values are mistakenly regarded by their adherents as something they have a right to. Protecting these "rights" violates actual individual rights.

Consider the "rights" to a fair wage or health care. For these to be rights, other people would have to be legally compelled to supply the fair wage or health care. But suppose that consumers would rather pay less for some item than is enough to pay workers a "fair" wage. If the fair wage were something workers were due by right, then consumers could be forced to pay it. Thus, consumers become captives of those claiming spurious rights, and not parties to free trade, as is required by a genuine theory of human rights.

Essentially, then, the rebuttal to the moral argument for government regulation based on human rights considerations holds that the doctrine of rights invoked to defend government regulation is fallacious. A sound doctrine would prohibit such regulation.

The rebuttal to the judicial inefficiency argument is, essentially, that whenever polluters cannot be sued by their victims or cannot pay for injuring others, pollution must be prohibited. In short, a policy of quarantine, not of government regulation, is the proper response to public pollution. As I have argued in "Pollution and Political Theory" (Tom Regan, *Earthbound,* Temple University Press and Random House, 1984), the courts, and not the legislators or regulators, must remedy the rights violations that pollution involves.

Obviously, this rebuttal sounds drastic. Adopting it would mean cutting back production in various industries, including transportation, at least until non-polluting ways can be found and paid for willingly. Yet, even though such production practices might be of value to millions of consumers, if innocent people are victimized in the process, it can be argued that these practices should be stopped.

A similar situation involves slavery or apartheid. Many Southerners benefited, at least at times, from this public policy, and many South Africans seem to benefit from apartheid. Nevertheless, from a moral point of view, these benefits are not decisive. The emphysema patient who chooses to do without many of the world's technological wonders shouldn't have to suffer the burdens which come from producing these wonders. Not, at least, unless it has been shown that these burdens justly fall on him.

Of course, the problem of pollution is complicated. For example, one car in the Los Angeles basin does not produce enough exhaust fumes to harm anyone because the fumes are diluted in the atmosphere. Likewise, one small factory with a tall stack might harm no one, thanks to dilution of its output. The same goes for liquid pollutants into a lake, river, or ocean.

Arguably, however, none of this changes the principle of the matter. Once a certain level of emission has been reached, any increase amounts to pollution. And permitting such pollution is tantamount to accepting as morally and legally proper the "right" of some people to cause injury to others who have not given their consent and who cannot even be compensated. A just legal system would prepare itself to deal with these complexities, as it does in other spheres where crime is a real possibility. The failure to do so is the root cause of our present pollution difficulties.

These, then, are the principal arguments for and against government regulation of business. What they show is that government regulation is not a legitimate part of a just legal system. Government regulation involves coercion over some people for reasons that do not justify such coercion. Of course, the practice also is highly inefficient. But is it all that surprising that something which lacks moral support also would turn out to be unworkable? □

The Rise (and Fall?) of the Video Store

by William B. Irvine

The popularity of the video cassette recorder (VCR) has given rise to a new economic phenomenon: the video store. Video stores are simply private libraries that lend video-taped movies rather than books. They are funded and operated not by government, but by corporations and individuals who hope to make a profit.

Across the country, video stores have proliferated at an astonishing rate. A decade ago, there were no video stores in America; today there are perhaps 40,000. In 1986, the nation spent $3.4 billion renting video-taped movies. It is estimated that this year Americans will spend more on video rentals than at movie box offices.

Despite such bright beginnings, the video store industry is in jeopardy. It is facing increasing competition from public libraries that are beginning to lend movies as well as books. If this trend continues, the video store industry will be devastated.

America's video store industry is slowly but surely being socialized, as the public sector takes over a service that is provided more than adequately by the private sector. If government tried to take over any other $3 billion industry, we would expect the move to be greeted by howls of protest. These howls haven't been heard in the case of the video store socialization, however, because the process has been nearly invisible: instead of coming in one fell swoop as the result of direct action taken by the federal government, the takeover is coming one municipality at a time.

How badly might video stores be hurt by public libraries' move into video loans? Consider the case of the Reverend Abiel Abbot, a key figure in the growth of the public book-lending library in America.

The Reverend Abbot was a firm believer in making books available to the masses. In 1833, he was instrumental in convincing the citizens of Peterborough, New Hampshire, to use state-provided money to start America's first "true" public library, the Peterborough Town Library. At the same time, he was engaged in the formation of a privately funded "social library," the Peterborough Library Company. In *Foundations of the Public Library,* Jesse H. Shera finishes the Reverend Abbot's story this way:

> Obviously, [Abbot] did not see the new public library as a competitor of the social library, but such competition began almost

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immediately. As early as 1834 dues in the social library began to lapse, and in 1853 the minutes of that institution record: "Since the establishment of the Town Library [the free public library], very few books have been taken from the Peterborough Library [Abbot's private library]."

It was not long thereafter that the private library closed its doors.

The lesson to be learned from this episode is that people will not rent something they can borrow "for free." This is a lesson, I think, that today's video store owners will do well to remember.

A case can be made that the growth of the public library in America slowed the growth of an otherwise thriving network of private libraries. Similarly, the growing willingness of public libraries to lend movies will likely stunt the growth of the video store industry. Indeed, I would not be surprised if in a decade video stores were as rare as private book-lending libraries are today.

Who Should Meet Consumers' Demand?

Should public libraries stock video-taped movies? Or should private video stores be allowed to continue to satisfy the public's desire for them?

There is widespread support for public libraries' ventures into video lending. These supporters believe that the interests of a community will be better served if people can borrow movies from public libraries rather than rent them from video stores. Two reasons are given to support this belief.

First, many will argue that public libraries will improve the availability of "good" movies. These people point out that video stores tend to stock "slasher" and pornographic movies, while public libraries would stock "film classics."

I am as depressed as anyone about the current selection of movies available at most video stores. Nevertheless, I think this is a temporary phenomenon. The owner of a new video store is likely to stock the films most likely to turn a quick profit—primarily "popular" movies. Once his store is on more sure financial footing, he is more likely to experiment with his selection of films.

It is wrong to assume that those who run video stores are opposed to "good" movies. They are not. And even if they were, they would not be likely to allow that opposition to stand in the way of profit. If a video store owner can make a profit by carrying a film classic, he will carry it.

It is similarly wrong to assume that public libraries will be more likely to carry "highbrow" movies than are video stores. My local public library, which is excellent as public libraries go, does a far better job of catering to popular tastes than of catering to highbrow tastes. If, for example, I want to read a novel by Louis L'Amour, I will find 28 (at last count) to choose from; if I want to read the novels of Turgenev, Balzac, or Zola, I am out of luck. Similarly, the Marx Brothers are far better represented in videos than is Karl Marx.

And there is another side to this availability argument. Private video stores respond to the public's demand for convenient locations and hours far more successfully than do public libraries. How "available" is a video-taped movie in a public library if you must drive to a neighboring suburb during weekday office hours to borrow it?

A second argument made by supporters of video lending by public libraries concerns cost. Many will argue that it is cheaper to borrow a movie from the library than to rent one from a video store, and for this reason alone public libraries should get into the video business.

This argument is based on the false belief that movies can be borrowed "for free" from public libraries. There is, as economists like to remind us, no such thing as a free lunch; the patron of a public library, whether he realizes it or not, is paying for the privilege of borrowing books and movies. He is, most likely, paying in the form of local taxes.

It is far from clear that public libraries would provide movies to the public at a lower cost than video stores would. I need not indulge in statistics to suggest that, as a rule, private enterprise provides goods and services far more cost effectively than does the government—and I doubt that public libraries, if they entered

PAT WATSON

Norman Miller (r.) serves a customer in his video store in Indianapolis.

the video business, would be an exception to this rule.

Even if public libraries could lend movies more cost effectively than do private video stores, public funding raises a serious question of fairness. Taxation would force everyone to fund a public video library, regardless of whether he uses it. Why should someone who doesn't even own a VCR be forced to subsidize his neighbor's movie viewing habits? If we rely on private video stores to satisfy the demand for video-taped movies, only those who watch the movies must pay for their entertainment—and this only seems fair.

Both reasons advanced to support video lending by public libraries are based on false assumptions. In addition, it is important to note that as the movie-lending business is socialized, private video stores will go out of business; when these stores go under, they will take their employees with them.

I believe the message is clear. Private video stores are likely to provide a better choice of movies to the public than would public libraries; private video stores can provide these movies more cost effectively and distribute costs more fairly; and allowing public libraries to lend videos would put a number of people out of work. Public libraries should stay out of the video business. □

Paradoxical Taxi Fares

by Joseph S. Fulda

Often, I commute to work on Long Island in the wee hours of the morning via so-called gypsy cabs—the unlicensed taxis which abound in my section of upper Manhattan. A flat rate (usually $20.00 plus tolls) is agreed upon at the start of the trip and paid at its close. Most of the time, the story ends there.

Sometimes, however, when we pass the airport on the way, an argument ensues. The driver points out that the fare to the airport is more ($30.00 minimum), yet the cost of that trip measured in time and mileage is less. So, he concludes, he has been had, despite his agreement to the terms and a clear, initial bid on my part stating the time involved (45 minutes) and the destination (Hempstead in Nassau County).

Is he right or wrong? And why? The prime principle of economics is that prices are determined by supply and demand, not costs. Some products may cost a quarter and sell for a half-dollar, while others go for a dollar yet cost only a dime to make. The second producer is neither a profiteer nor an exploiter, and the first producer is neither a benefactor nor a patron. Both producers merely respond to market signals based on supply and demand.

To return to the taxi fare, the market price for a commute to the heart of Nassau County is indeed less than the market price for the shorter, faster trip—in the same direction—to the airport. That this is so is evidenced by the very facts of the case: I can always obtain a taxi at the lower rate for the longer, slower trip.

Why this is so is a bit more subtle. A taxi is the only sensible means of travel to the airport, especially during the wee hours of the morning. Commuting, on the other hand, can easily be accomplished by rail—much slower, yet much cheaper—or by car pools with other early birds. Moreover, people are willing to pay more for an occasional trip, when loaded down with baggage, than when they must make the trip several times a week. Furthermore, the number of gypsies emptily speeding about during these hours is very high. Many drivers consider themselves lucky to get *any* substantial fare at that hour; a few have even suggested a regular contract!

Put in economic terms, the demand for cabs at the time I commute is very low, especially for commuter trips. The choice facing a would-be supplier is often not an airport trip or a commuter's trip, but a commuter's trip or no trip at all (or perhaps a few local trips). Later in the day, during rush hour, when the demand for taxis is far greater, the gap between airport fare and a commuter's fare narrows, for the demand for taxis is far closer to the supply of taxis available for hire.

The law of supply and demand can sometimes appear to have paradoxical results, but if one truly understands the principle and also knows the market situation involved, the paradoxes disappear. □

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CAPITALISM FOR KIDS

by Karl Hess

Enterprise Publishing, 725 Market Street, Wilmington, DE 19801
1987 • 247 pages • $14.95 cloth, $9.95 paperback

Reviewed by Carl Helstrom

Karl Hess has written a book for children and for those who care about children. He deals with the philosophical and practical problems of society and presents capitalism—the free market, private property system—as the best solution. As he sums up in a section for parents toward the end of the book, "The proposition of this book has been, simply, to put in terms that young people can appreciate, the meaning of capitalism and the free market, to encourage them not only to understand it but to become a part of it, to share its ethics of individual responsibility, and its rewards—and to do it while they are very young."

Hess places strong emphases on ethics and entrepreneurship. The capitalistic system is best, he says, because it encourages people to be open to new ideas, to be ready to change, and to be able to make choices which, from an economic perspective, are beneficial for all. In such a society each person is responsible for his or her actions and is encouraged to practice honesty, integrity, and fairness—aware that such actions foster practical and material success. Hess encourages youngsters to start their own businesses, to plan well, to develop a strong work ethic, and to be ready to answer for mistakes and liabilities.

This book fills a real void in the literature of freedom. I wish it had been around when I was a kid. □

THE NEW CHINA: COMPARATIVE ECONOMIC DEVELOPMENT IN MAINLAND CHINA, TAIWAN, AND HONG KONG

by Alvin Rabushka

Pacific Research Institute for Public Policy, 177 Post Street, San Francisco, CA 94108 • 1987 • 254 pages • $32.50 cloth, $12.95 paper

Reviewed by Tommy W. Rogers

Why have Taiwan and Hong Kong experienced greater economic progress than mainland China? And why has the economic vitality of mainland China increased since 1978? While the thriftiness, diligence, and other virtues of the Chinese people have resulted in their flourishing almost everywhere they have settled, the Chinese culture thesis cannot account for sharply higher growth rates in Taiwan and Hong Kong than in mainland China during the past three decades, nor account for the fact that per capita income in Hong Kong in 1985 was thirty times that of mainland China. In fact, mainland China enjoys a greater abundance of natural resources than either Taiwan or Hong Kong, which suggests that other factors, such as political stability, economic institutions, secure property rights, the rule of law, and individual incentives play important roles.

The author concludes that the postwar development experiences of mainland China, Taiwan, and Hong Kong demonstrate that economic institutions matter more than cultural traits and natural resources in fostering economic growth and raising living standards. The Chinese, like other peoples, respond to incentives. These incentives are determined by political and economic institutions, which supply the rules and mechanisms for enforcement. The key rules include the definition and enforcement of property rights, which encourage improved productivity and the expectation that individuals will reap the rewards of their own work or investments. The Chinese have flourished where the economic environment has been free and competitive, with property rights secured under the rule of law. □

RIGHT MINDS: A SOURCEBOOK OF AMERICAN CONSERVATIVE THOUGHT
by Gregory Wolfe

Regnery Books, 1130 17th Street N.W., Washington, DC 20036
1987 • 245 pages • $16.95 hardback

Reviewed by William H. Peterson

"There is nothing either good or bad, but thinking makes it so," said Shakespeare. But what thinking? And *whose* thinking? Ideas, Richard Weaver reminded us, have consequences. Right thinkers on thinking should be welcome, then, and Gregory Wolfe portrays them well.

To Wolfe, editor of *The Intercollegiate Review* and an English professor at Christendom College, right thinkers are conservative, free-market, limited-government types. Their answers on such matters as family, media, crime, welfare, education, race, philosophy, sexuality, communism, economics, foreign policy, and so on are based on traditional time-tested values and are referenced here, an incisive guide to the width and depth of the intellectual framework undergirding today's conservative movement.

The Wolfe sourcebook is America-oriented even if some of its thinkers are European in origin—Erik von Kuehnelt-Leddihn and Ludwig von Mises, to name two examples.

The book has three parts—an annotated bibliography of conservative writings from John Adams to Walter Williams, brief biographies of American conservative minds including Norman Podhoretz and Leonard Read, and current sources of American conservative thought including the Liberty Fund and the Hoover Institution on War, Revolution and Peace. The inclusions—and there are hundreds—make sense.

Inevitably, I suppose, Mr.Wolfe can be charged with some errors of omission if not commission in a work of this sort. But given his limitations of space, he, too, had to *choose,* i.e., to reject. In the foreword to this reference work, William F. Buckley Jr. reminds us how Samuel Johnson coped with the demand for an explanation of why he omitted some word or other from his *Dictionary:* "Ignorance, Madam, pure ignorance."

Even so, this compilation of right thinkers and thinking should prove to be a valuable roadmap to conservative intellectualism. □

THE FREEMAN
IDEAS ON LIBERTY

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1988
VOL. 38
NO. 8

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THE FREEMAN
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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Thomas C. Stevens, chairman; Ridgway K. Foley, Jr., vice-chairman; Paul L. Poirot, secretary; H.F. Langenberg, treasurer.

The costs of Foundation projects and services are met through donations. Donations are invited in any amount. Subscriptions to *The Freeman* are available to any interested person in the United States for the asking. Additional single copies $1.00; 10 or more, 50 cents each. For foreign delivery, a donation of $15.00 a year is required to cover direct mailing costs.

Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

On the Inside

The transmission and use of so-called inside information has been made to seem invidious by the recent hit movie *Wall Street*. Passing "inside" information is, in itself, a mere exercise of free speech and a benign one at that, since the information is true and the spread of the truth is no evil. In the movie, though, the information was gained by filial betrayal and by cloak-and-dagger operations that would embarrass the CIA.

Likewise, the use of true information to guide one's actions is paradigmatic human rationality. So-called market manipulation—buying low and selling high—is no more than any businessman does, and the better his knowledge of when something is undervalued, the greater will be his profit. Moreover, it is impossible to draw a clear line demarcating "inside" information from other information. In the movie, though, the information is used for both revenge and betrayal—to hurt people.

Movies like *Wall Street,* as entertaining as they may be, do little to enhance public understanding about the realities of the business world. Instead, they create undeserved animus and lead to erroneous generalizations. How unfortunate.

—JOSEPH S. FULDA
Hofstra University

Overcoming Racism

I have found that if you can make yourself indispensable to people, if you can produce a product that is better than any other product, if you can give people something that they cannot get anywhere else, they will forget about race and they will forget about everything of that nature. I don't run into a lot of prejudice with anyone if I'm making money for them; I don't have any problem with my printer; I don't have any problem with anybody if they need me. And so what we need to do, we need to make ourselves indispensable. We need to be so good at what we do that people need us, and if they need us they will support us.

—JOHN H. JOHNSON, Chairman
The Johnson Publishing Company
publisher of *Ebony* and *Jet*

Steel Blues, Part I

In 1984, the Reagan administration persuaded major steel exporters to restrict their shipments to the U.S. market. The goal was to reduce the share of steel imports from 26 per cent to 22 per cent of total domestic sales and, in the process, to create jobs in the beleaguered U.S. steel industry.

Did the plan work? That depends on how you look at it. According to a study by Washington University economist Arthur Denzau ("How Import Restraints Reduce Employment," published by the Center for the Study of American Business), by 1986, the "voluntary" trade restrictions had added an estimated 16,900 jobs to the U.S. steel industry.

But the restrictions also raised steel prices, making it more difficult for U.S. auto makers and other American producers who use steel to compete in world markets. Because of the trade restrictions, Denzau found, the U.S. metal fabrication industry lost 26,000 jobs, nonelectrical machinery lost 11,800 jobs, electrical machinery suffered 4,600 job losses, and transportation equipment lost 7,600 jobs.

The net employment effect of the trade restrictions: the loss of more than 35,000 American jobs. —BJS

Steel Blues, Part II

Caterpillar Inc. of Peoria, Ill., is having trouble getting the steel it needs to build tractors for a $2.2 billion export business that employs 14,000 people. The company has asked U.S. mills for more steel, but the mills cannot deliver it. Nor can Caterpillar get steel from overseas, because U.S. quotas imposed in 1984 limit imports. The shortages are now constricting Caterpillar's exports. . . .

Steel import quotas are forcing Davis Walker Corp., the largest steel wire maker on the West Coast, to pay a 10 percent to 15 percent premium over world prices on its steel. . . .

Scotchman Industries Inc., a machine tool maker in Philip, S.D., has seen steel prices from domestic mills rise 17 percent to 25 percent in the past year. . . .

Quota-induced price increases are filtering through to housing prices, says John P. Hayes, chairman of National Gypsum Co. of Dallas, because steel is a large component in construction. "If we have a demand for, say, 1.5 to 1.6 million houses a year, and we can only sell 1.3 to 1.4 million because of high prices, why that means all of those jobs for people to build to that demand level won't be there," he says.

—*Insight,* March 14, 1988

The Unseen Governors

Several years ago I began asking students in my college class to tell me who keeps order in Grove City, Pennsylvania, a town of 10,000, when college is in session. They invariably responded, "the local police," or "the Pennsylvania State Police," or "the campus security officers," and then, sometimes, "the Dean of Men." The students were convinced that societal peace and order were produced almost entirely by what might be called the *visible* governors—most often officials of the State. But then I pointed out that in our town, if just 500 citizens decided to do wrong, our dozen local policemen, a handful of security guards and the officers of the closest state police barracks ten miles away would be hard pressed to bring the five per cent of the population under control. "How," I ask them, "could order ever be maintained if all 10,000 people set out to disobey the law?" The orderly existence we enjoy in towns like Grove City is not the product of the threat of statist force. The orderly and free society we have is due primarily to the presence of unseen governors—*not* primarily to billy clubs or the rotating red light of squad cars. To emphasize, order in communities results from the *inhibiting* (dare I use that now disreputable word) restraints of morals, religious convictions, conscientious scruples, and the regularizing and meliorating bonds of custom, tradition, usage, and observance.

—John A. Sparks
Grove City College

THE FREEMAN
IDEAS ON LIBERTY

The Border Closed at Midnight

by Dagmar M. Anderson

With a jerk, the train slowly began leaving the station. We passed houses, factories, railway crossings, just barely visible in the darkness. I looked out the window beaded with raindrops, saying good-bye. The gentle swaying of the train soon became monotonous.

If anyone had told me three months earlier that my family and I would be fleeing our native Czechoslovakia, with all our belongings packed in five suitcases, and an uncertain future ahead, I would have told him that was as unbelievable as the day it all began . . . August 21st, 1968.

My ears began attending to a distant sound. It was coming closer. The closer it got, the louder it got. What was it? I had never heard that before. Then my whole room began to shake. An earthquake? I was fully awake now. I frantically dove out of bed to look out the window. It was still dark outside. Leaning over the edge I had to plug my ears because the noise was so loud. A long line of large dark silhouettes was slowly creeping up our one-way street. Tanks? That's what they looked like. Army tanks. What was going on? Didn't they know it was 3 a.m. and people were trying to sleep?

Mrs. Anderson, who lives in Port Coquitlam, British Columbia, is a full-time college student, an employee of the Douglas & McIntyre Publishing Company, and the mother of four children.

The author dedicates this article to the memory of her grandfather, Eemil Skala.

I ran to the mantel to turn on the radio. Silence. And then it hit me: *War! This must be war! Grandfather! I must wake up grandfather. He'll know!*

I ran out of my room, through the dark kitchen, through the dining room, the living room, to his bedroom, which faced the back yard. He was a sound sleeper; he wouldn't wake up even if the tanks were to go right by his bed.

"Grandfather!" I shook him. "Wake up, Grandfather! I think it's war! There are tanks in the street!"

He put his glasses on, and we both ran through the dark house, back to my room.

"Those look like Polish tanks." He was remembering World War II. "What do they want here?"

The radio broke its silence. "Citizens . . . citizens . . . please go to work as usual . . ." The reception was really bad. "Please, remain calm . . . There must be an explanation for their being here . . . This must be some sort of a mistake . . . We are still unable to reach the President. . . ." Static and crackling broke in. It was a woman's voice. Not the usual announcer. Her voice shook. "We have had reports from everywhere across the country . . . There are tanks all over . . . Please, remain calm . . ." Silence. No commercials. No music. Nothing. Just silence.

Grandfather, with his head down and his broad shoulders stooped, dropped his weight into a chair. He was speechless. I stared at him. The great man I admired so much now sat before me, defeated. I put my arms around his big

WIDE WORLD

Tanks move into Wenceslas Square in Prague, August 21, 1968.

wide neck and sat on his lap. We just sat there, silently, and we cried.

All night long we listened to the crackling voice of the radio announcer. There was no real news until 8 a.m.: "Friends . . . neighbors . . . Around midnight last night . . . five countries . . . crossed over into our country . . . They are . . . East Germany . . . Bulgaria . . . Poland . . . Hungary . . . and Russia . . . We still don't know why they are here . . . There have been no reports of casualties or injuries to our citizens . . . We will let you know more, as soon as we can . . . as long as we are able to . . ."

For the rest of the day, the long loud lines of tanks kept snaking their way up the streets of my grandfather's home town, heading for Prague, 80 kilometers to the south.

All my life I had been coming to this place to spend my summer vacations, spring breaks, and Christmas. I was practically raised by my grandparents. Everyone in town knew me as Mr. Skala's granddaughter. My grandfather was an important man in this town. Everyone respected him and listened to his advice. Grandma's nickname was "Angel"—because that is what she was. She spoiled my brothers and me the way no one else did. Life with the two of them was like a vacation every day. We were always happy here.

Now, I didn't understand anything that was going on around me. There were no answers to any of my questions.

One week later, my brothers and I were returning home to Prague on the bus. We were very fortunate to be on the bus. The closer we got to the city, the more soldiers became visible, the more tanks, the more guns. Prague looked as though it had been through a war. Windows on buildings were shattered from bullet holes; the National Museum at the crown of Wenceslas Square got the worst of it. The magnificent stonework, centuries old, on the face of the building was practically destroyed. Everywhere I looked were barricades, sidewalks broken up, cobblestones on the streets turned upside down. There were signs of war everywhere we looked, and yet we were told this was no war. There were words painted on buildings: "Go home . . . We don't want you here . . . Go back to where you came from."

Our national army's weapons had been con-

fiscated. We were left defenseless, empty-handed. Everyone was ready to fight. But we were told to stay calm, to do nothing. During the previous week our radio and television stations had been taken over, even though it took a while to find out where they were. Everything stood still. No one was coming in; no one was leaving. Curfew was at 8 p.m. No one was allowed on the streets, not even emergency vehicles. Our borders were closed.

Many people were shot while trying to fight back. Poor fools. Throwing cobblestones at the tanks. The whole country was in confusion; no one had a straight answer.

The next week I was supposed to go back to high school. All summer long I'd looked forward to it. Now, I didn't even know if I'd ever see my school or my friends again. I wondered how long this was going to last. *Why are they here?*

Two months later. November 8th. All schools had opened on time in September. Things were kept as normal as could be expected, but nothing was really changed. Tanks were still everywhere. Shattered windows hadn't been replaced. The curfew was now at 10 p.m. instead of 8. There were great shortages of food. Lineups for bread, milk, eggs, and fruit started at five a.m. There was no meat available at all. People were getting used to the tanks and the soldiers, but there were still no explanations for why they had come. We hadn't heard from our President yet.

I began to notice my uncles and aunts coming over for short, discreet visits. Each one of them walked away with one of our appliances or a piece of our furniture. I didn't know what was going on. Why was my mother giving away all our stuff? Everyone talked in hushed voices. I heard my parents say that our relatives came over one at a time so the neighbors wouldn't get suspicious. Of what? After all, they were our relatives, and they had always come over before. So why would anyone be suspicious of that?

One night I saw my mother's friend from next door, who was a seamstress, sewing an extra pocket into the lining of my father's new leather coat, under the existing pocket. Wow! My father pulled out a thick stack of money from the bottom drawer of the bureau. I had never seen so much money in my life. It took him a long time to count it all out. He took out several bills and handed the rest to our neighbor, who expertly sewed it into the secret pocket.

That weekend my grandparents came to visit. I was so happy to see them again. I noticed grandfather's embrace of me was extra long. He almost squeezed life right out of me. Grandmother cried a lot, and hugged me a lot. Why was everybody so upset? It felt like somebody had died. They all walked around with long faces. No one was loud as they usually were whenever they got together; everyone whispered. There was no happiness, no laughter, no jokes.

When my grandparents were leaving Sunday night, they couldn't say good-bye to us. I smiled at them and said: "Grandma, Christmas is only five weeks away. We're coming over like we always do. So why the waterfalls? You're acting as if you'll never see us again!" That did it! I didn't understand what I had said wrong. Confused, I waved as they walked away toward the bus station.

On the morning of Wednesday, November 13th, as I was getting ready to go to school, my mother said to us children: "You're not going to school today. You are going to stay at home." *I am? Why?* I wasn't going to argue. I was happy to stay home. "Great!" I replied. Then my father poked his head into my bedroom, which I shared with my brothers: "How'd you like to go shopping with me?"

"Oh, I'd love to!" I jumped up and ran to him to give him a big hug. It was the first time in months I had seen a smile on his face. It was the first time he had ever asked me to go shopping with him.

We took a streetcar downtown. At a department store we purchased five new suitcases and some odds and ends. Walking home my father said to me, handing me a 50 *crone* bill, "Here, go get yourself something, anything you want."

I never had had so much money before!

I kissed him, "Really! . . . Oh, wow, thank you, father." Being a typical teenager, I

headed for the first record store we came up to and spent all the money on records. My father didn't object. That in itself was hard to believe.

Arriving at home with all our purchases, we were greeted by my brothers, and my mother's worried face. We each were given a suitcase. "Pack whatever you want in it, whatever is dearest to you." My mother spoke softly.

"Where are we going? On a trip? Where to? For how long?"

"Don't ask, just do what I said."

This is great! I wonder where we're going? I packed all my records, my favorite books, my photo albums, some of my personal things, and only a few pieces of clothing.

At 4 p.m. we listened to the news. The border was open again. For now.

We arrived at the train station at 6 p.m. Our train was scheduled to leave at 7:30 p.m. We walked to the station restaurant (I had been to a restaurant only four or five times before), and had a nice dinner.

We boarded the train at 7 p.m. Our sleeping compartment, which we had all to ourselves, had six beds in it. We'd be able to sleep, as we were to travel all night long.

It was then that our parents revealed our destination to us. It was Austria, actually, Vienna, the capital city. We were going there to visit our Aunt Martha. I never knew we had an aunt named Martha in Vienna. When I questioned it, my father said, "Hush up!" I remained quiet. My father wore his new leather coat, which he carefully hung up by the window.

The swaying of the train must have rocked me to sleep. Suddenly, my sleep was interrupted by a flashlight pointed directly into my face. From behind the bright light I heard: "Passports, please . . . passports, please." Poised to strike, the conductor officially scrutinized each document, comparing our faces to the photographs in the passports.

"Where are you going?" He directed his question to me.

"To Vienna, to visit my Aunt Martha."

"Have you ever been there before?"

"No, but I can't wait! . . . See? . . . I even brought my ice skates!" I dangled them in front of his face. A smirk briefly appeared in the corner of his mouth.

He proceeded to search every piece of our luggage, our purses, even our pockets, systematically, very officially. My heart stopped pounding, lodging itself in my throat for a split second, when he frisked my father's leather coat!

"Everything seems to be in order here . . . Thank you!" He saluted, turned, and walked toward the next compartment. I slowly released my breath, unaware till then that I was holding it. I could see the relief in my parents' faces as they looked at each other. We hugged and slowly began to relax and make ourselves comfortable again.

The train stood motionless as the conductor proceeded to check the rest of the compartments on the train in the same manner as he had ours. The inspection took a long time. It was 11:30 p.m.

We overheard a group of young people in the compartment next to ours laughing and shouting as soon as the conductor left them. "This is fantastic! Now we can go anywhere we want! Can you imagine! Australia, America, Africa, Canada! Anywhere we want! We'll never come back here!" I was shocked to hear them talk this way. I wondered if the conductor heard them as well.

As soon as he finished the inspection of the entire train, he came back. With his index finger he motioned them over, and in the deep voice of authority said: "Would you all come along with me, please!"

My father whispered to my mother: "That's it for them! They'll never get another passport as long as they live! It wouldn't surprise me if they got thrown in prison!"

We arrived in Vienna at 8 a.m., stored all our luggage in lockers, and headed straight for the Canadian Embassy. We were among hundreds of refugees. Most of them were single people, or married without children. We were the largest family there. We were granted asylum almost immediately, along with tickets for a plane which was leaving in 10 days. We heard that most people waited six months to a year in refugee camps to get on a plane to Canada.

On the local radio station we heard that the Czechoslovakian border had been closed at midnight. Ours was probably the last train to get out. □

Soviet Military Strength Based on Economic Weakness

by Dwight R. Lee

Why was Mikhail Gorbachev willing to sign the Intermediate Nuclear Force (INF) treaty which calls for the elimination of all U.S. and Soviet intermediate range nuclear weapons in Europe? One obvious answer is that the Soviet Union has an advantage over the West in conventional forces. But this raises another troubling question. Why, in the face of a weak Soviet economy, is Gorbachev willing to shift toward conventional forces, when nuclear weapons are relatively cheaper? Haven't we heard repeatedly that the Soviets are sincere in their stated desire for arms control because they cannot afford an expensive arms race?

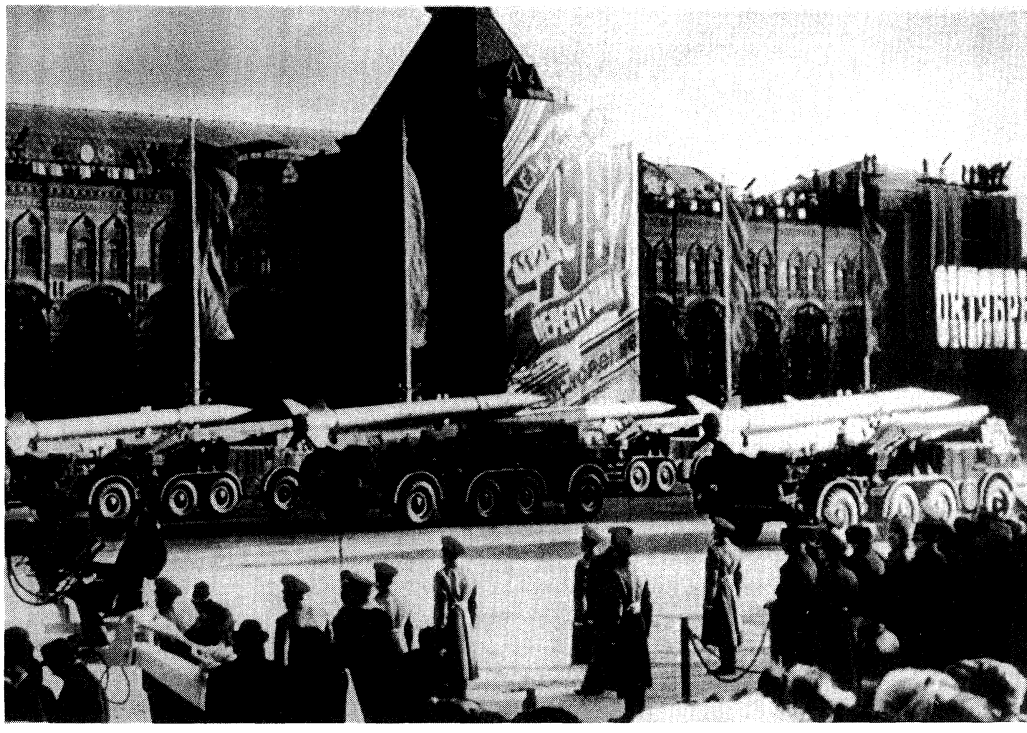
There is no doubt that the Soviet economy is weak, especially the civilian sector. Economic decisions in the Soviet Union are controlled predominantly by central planners, and will remain so into the foreseeable future, Gorbachev's policy of *perestroika* notwithstanding. Central planners are incapable of either acquiring or acting upon the information needed to keep production decisions responsive to the changing preferences of millions of consumers. This explains why the Soviet civilian economy is characterized by unimaginative managers, poorly motivated workers, inferior products, and chronic shortages.

Dwight Lee is professor of economics at the University of Georgia and holds the Ramsey Chair in Private Enterprise.

Contrary to the prevailing understanding, however, poor economic performance encourages military spending in the Soviet Union. It does so in two important ways. Economic inefficiency in the Soviet's civilian sector 1) increases the importance Soviet leaders attach to military strength and 2) reduces the costs of producing that strength.

In contrast with the United States, the Soviet Union is a superpower for one reason only: its military strength. Without its military power, the Soviet Union would be a large but poor country, and its leaders would have little standing or influence in the world community. Within the Soviet power structure, the impotence of the economy accentuates the importance of the military.

Poor economic performance also reduces the real cost of Soviet military spending. The cost of producing anything, whether bombs or band-aids, is the value of output that must be forgone. The Soviet Union may be less efficient absolutely at producing military hardware than the U.S., but the production of military equipment costs less in the Soviet Union because, with its inefficient civilian economy, this production crowds out less civilian output than it does in the United States. The Soviet Union has what economists refer to as a comparative advantage in producing military power.



WIDE WORLD

Soviet missiles in Red Square during festivities marking the anniversary of the Russian Revolution.

Soviet leaders have responded predictably to this comparative advantage. They know that if the Soviet Union were to distribute its resources among the military and civilian sectors in the same proportion as does the U.S., then it would cease to be a superpower. But a large sacrifice in military strength would produce little improvement in what would remain a weak civilian economy. Thus, Soviet leaders have lavished resources on the military sector, and created the military machine we confront today.

The INF treaty raises the costs of the military competition between the U.S. and the Soviet Union because it increases the emphasis on conventional weapons. Despite the overwhelming economic advantage the U.S. and its NATO allies have over the Soviet Union and its Eastern European allies, any arms agreement that increases the costs of military competition plays to Soviet strength. The Western democracies can compete dollar for dollar with the Soviet bloc militarily, but there is little evidence that they will.

In economically efficient democracies, strong political pressures exist to subordinate military spending to civilian consumption. The convenient belief is that the same pressures exist within the Soviet Union, and are intensified by the weakness of the Soviet economy. This is a delusion. The ever-present danger in a democracy is that delusions will control our decisions. This danger is at no time more threatening than when it leads to attempts to increase our security by trusting in arms control agreements such as the INF. □

School Censorship: Compulsion Creates Conflict

by John Semmens

"School Censorship Upheld" read the headline in my city's daily newspaper. The January 13th ruling by the Supreme Court that school officials have the right to control the content of the student newspaper is stirring controversy. Unfortunately, little attention is being directed to the root of the problem: *public* schools.

It is because the schools are publicly owned and operated that an otherwise reasonable act takes on sinister potential. It is the existence of tax-financed education that creates the inevitable clash of individual rights. That is, both sides of this case have legitimate rights. The resolution of the case *in either side's favor* tramples the rights of the other side.

The Court's logic was sound in asserting that the school, since it sponsors and funds the student paper, has a right to exercise editorial control. To deny this right would amount to requiring someone to fund the publication of ideas he finds offensive or harmful. Some 200 years ago, Thomas Jefferson correctly condemned forcing a person to finance ideas he opposes.

On the other hand, critics of the Court's decision are justified in their fears of growing suppression of expression. The recent trend in Court decisions has upheld warrantless searches and censorship of speech within schools. The extension to student papers is in line with these earlier findings.

If schools were private institutions, privately financed and voluntarily attended, there would be no case to bring to court. Private institutions would have discretion over whether there were a student paper and what its content might be. Those who didn't like the way this discretion was exercised would be free to take their business elsewhere. Competition among private schools would lead to a diversity of approaches to this issue.

When schools are public, though, there can be no equitable resolution of the problem. Those who find their local schools unsatisfactory, for whatever reason, are not really free to take their business elsewhere. Students are permitted to attend state-approved alternative schools, but not to select unapproved alternatives. Even if the student leaves the public school, his parents aren't free to withdraw their tax support. Parents may send their child to a state-approved private school, but they still will be required to pay for a public school education not received.

The heavy tax burden for public education effectively limits the schooling choices for many people. Though they might like their child to attend a private school, many parents cannot afford to pay twice for one education. In short, many children are *forced* to attend public schools.

Because of the compulsory and collectivist

John Semmens is an economist for the Laissez Faire Institute, a free-market research organization in Tempe, Arizona.

method of financing the public schools, the violation of rights is guaranteed. The student writing a controversial article for the school paper has paid (in the form of his parents' taxes) for part of the cost of the support of the publication. Other taxpayers, who also have paid part of the cost, do not want their tax dollars to fund this controversial article. Whether the article be printed or suppressed, someone's rights will be violated.

That compulsion and collectivism should threaten free expression is amply demonstrated by conditions in the Soviet Union. The Soviet constitution guarantees a free press. At the same time, though, the government owns all the presses. Obviously, the government cannot allow valuable and scarce resources to be wasted on the expression of "frivolous" or "harmful" ideas. Consequently, the constitutional guarantee is meaningless. Similarly, the attendees of public schools are finding their constitutional guarantees of a free press to be meaningless in a collectivized institution where the authorities own the presses.

The only way to protect the rights of those who express ideas, as well as the rights of those who must pay for the publication of the ideas, is to discontinue the use of compulsion in education. Taxpayers should not be compelled to pay for schooling they neither want nor use. Students should be free to attend any school they or their parents are willing and able to pay for.

Ending coercion in schooling would go a long way toward demonstrating our understanding of and commitment to freedom. A truly free education would eliminate a major source of conflict and injustice in our society. □

IDEAS ON LIBERTY

The Locus of Sovereignty

The ultimate source of the educational crisis stems from an error in first principles. Once committed to this error, the public education system has floundered repeatedly. To locate the source of the error, men need only ask themselves a single question: Who is responsible for the education of a child? The answers, of course, are varied: the parents, the church, the civil government, or a combination of the three.

The conflicts in education are in fact conflicts over a much more fundamental issue: the locus of sovereignty, and hence, the locus of personal responsibility. The person or institution which possesses sovereignty must be the one which takes on the responsibility. By affirming the legitimacy of tax-supported education, voters have attempted to transfer their responsibilities for the education of their children to another agency, the state. Yet, at the same time, they affirm their own sovereignty over the content and structure of the educational system. That they have lost almost every battle in their war with tenured, state-supported educational bureaucrats, is the direct result of the public's abdication of personal responsibility, family by family, for the education of their children. The war was lost on the day that parents, as voters, decided to transfer the financial responsibilities of educating their own children to other members of the body politic.

—GARY NORTH

Privatizing the Judiciary

by Daniel J. Popeo

As tight budgets have inclined some state governments and Federal executive agencies to search for alternatives to expensive government services, "privatization"—the shifting of government functions to the private sector—has finally become an acceptable option to pursue. Curiously, however, the idea of erecting a private judiciary as an alternative to the nation's judicial system—a system in danger of becoming immobilized by an onslaught of litigation—has received little attention. Yet there is no reason why the idea couldn't work in the judicial setting as well.

In fact, the litigation explosion that occurred in the 1970s (coupled with a simultaneous increase in judicial activism) has already caused a small number of entrepreneurs to set up alternative dispute resolution systems. The purpose of these systems is to ease the current judicial bottleneck, to allow for expeditious dispute resolution, and to open up the judicial process to a class of litigants who are finding it increasingly costly to use the public court system.

The Problem: A Judicial Bottleneck

There are two reasons for the recent bureaucratization of the judicial system: an increase in legal activism (which encourages parties and lawyers to seek judicial redress of an ever-increasing list of judge-made legal "wrongs") and the government's inability to respond to the courts' added work load.

In 1960, the U.S. District Court system registered a mere 80,000 case filings. Today, by contrast, the most recent Annual Report of the Administrative Office of the U.S. Courts records that plaintiffs filed 238,982 civil cases from June 1986 to June 1987. That growth represents a 200 per cent increase in civil litigation. Actual court days have increased only 40 per cent during the same period.

The major cost to parties that this judicial bottleneck creates derives from the long discovery periods preceding trial. From the date of filing, the average civil case takes 20 months to get to trial. This in turn has led to a huge backlog in civil cases. For example, 243,159 civil cases were pending as of June 1987.

Although excessive delays and broadened discovery methods produce a financial boon to lawyers, the litigants (both individual and corporate) have suffered. According to *The Practical Lawyer* (March 1985), an insurance company will pay an average of $32,000 in legal fees out of every $100,000 judgment that is awarded. Moreover, if a plaintiff wins $100,000, he can expect to take home up to 15 per cent less than what he would have recovered if he had received the compensation at the time the award became due (the time of the injury). This is because he has lost interest over the three-year waiting period preceding judgment.

The public also pays through higher taxes and lost national productivity. Currently, tax-

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This article first appeared in WLF's Legal Backgrounder *series.*

payers spend $10,000 a day to keep each Federal district court operating. In some states the cost may be even higher. For example, Arizona taxpayers dole out $24,000 per day to keep their Superior Court system functioning. According to the National Insurance Institute, in 1985 insurance companies paid nearly $85 billion in casualty claims, but spent an additional $16 billion in legal fees. This lost revenue is recouped from the general public in the form of higher premiums for individuals and businesses. Higher premiums, in turn, raise the costs of goods and services to all consumers.

A Private Judiciary

Although most of the for-profit companies that provide Alternative Dispute Resolution ("ADR") and private courts did not appear until the early 1980s, they have already been quite successful in accommodating the increasing demand for efficient and fair adjudication. The precursor to these for-profit companies is the American Arbitration Association ("AAA"). Although the AAA has principally been used by businesses to solve contractual disputes, parties are now using AAA guidelines and services to resolve other types of claims.

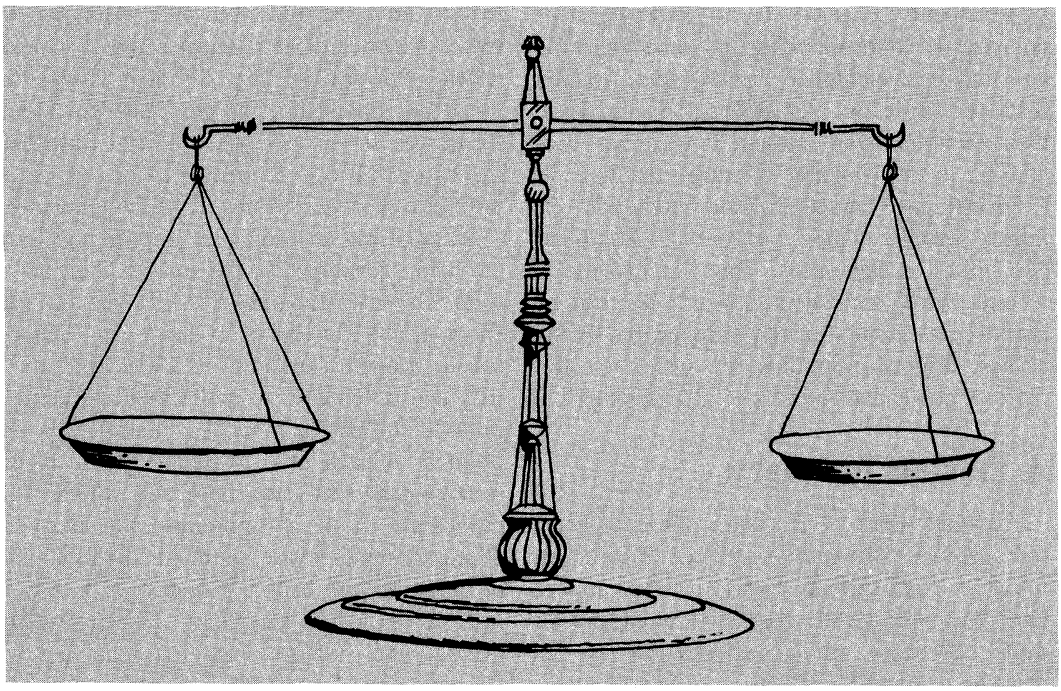
Businesses with contract disputes have increasingly turned to arbitration to settle them. In 1971, the American Arbitration Association conducted 22,549 dispute resolutions. By 1986, that figure more than doubled to 47,202. This trend is supported by former Chief Justice Warren Burger who has said, "If the courts are to retain public confidence, they cannot let disputes wait two, three and five years or more to be disposed of."

Companies like Endispute, based in Washington, and the Center for Public Resources ("CPR") in New York, have followed the AAA's example by providing services in addition to deciding contractual disputes like those handled by the AAA. Endispute, like CPR, deals with mediation, arbitration, and mini-trials in what CPR refers to as "win-win solutions," in contrast to the purely adversarial outcome of litigation. For example, Endispute has participated in patent and antitrust issues relating to the chemical and aerospace industries, as well as in an important mini-trial that resulted in a $61 million dispute settlement between American Can Company and Wisconsin Electric Power Company. Although groups like the AAA, Endispute, and the Center for Public Resources serve only quasi-judicial functions, their growth is directly related to the judiciary's failure to resolve disputes in a timely manner.

Alternatives to traditional dispute resolution are being developed in the area of libel law as well. The Iowa Libel Research Project, an offshoot of the University of Iowa Law School, has developed a program to allow libel plaintiffs and defendants to settle their differences outside the courtroom. A "neutral" is appointed in each case to decide if the media statement at issue was false and whether the reputation of the complainant was harmed. Often the remedy is to get the media to publish or broadcast the neutral's finding or to pay to have it published elsewhere. Given that the average libel suit now lasts four years and that 73 per cent of plaintiffs say they would be happy with a retraction, correction, or an apology, it would seem that non-traditional dispute resolution in this sensitive area has a promising future.

Perhaps the most dramatic result of the disillusion with the current judicial system has been the creation of actual "shadow" courts run by for-profit companies. Two examples of these private initiatives are the publicly owned Judicate (now located in all 50 states and the U.S. Virgin Islands) and the Arizona-based CiviCourt. While associations and companies like AAA, Endispute and CPR provide expert mediation and consulting geared toward dispute resolution, these shadow courts actually hear cases and hand down legally binding decisions.

While some in the legal establishment suspiciously view these for-profit companies as a potential vehicle for "abuse and injustice," the result has been just the opposite. CiviCourt director Alice Wright has noted the companies' very existence rests on pleasing both the plaintiff and the defendant. If abuses take place on a significant scale, demand for their services will drop. At CiviCourt and Judicate, the parties are allowed to select the judge they wish to try their case. Selections are made from a list of senior and retired judges. The parties also decide what rules of discovery and evidence will be used



and whether the decision will be legally binding. The companies stress fairness to both parties. As one superior court judge familiar with Judicate has said, "If they don't, they'll be out of business."

One advantage of companies like Judicate is that they generally issue clearer and more concise opinions with no intent to set legal precedent for other parties. Since decisions are confidential, they are not published. Thus a savings in time and money results from avoiding overly verbose and prospective opinion-writing.

The Future

Whether it is an arbitration clause in a contract or patent infringement claims against a company, more and more potential litigants are solving their problems outside the courtroom. They are doing so for one main reason—the need to settle their disputes without the ruinous consequences of prolonged, expensive litigation. Cases now being handled by ADR companies include antitrust, personal injury, medical malpractice, insurance, and practically all other non-criminal disputes.

As long as a significant backlog of cases exists in the nation's courts, the private ADRs will continue to have an incentive to provide inexpensive, speedy, and just judicial services. Although the private sector is not currently large enough to markedly relieve the state and federal governments' caseload, a strong profit motive exists to expand. If dispute resolution continues to offer cost-efficient and fair adjudication in areas previously left to the government, industry growth potential is enormous given the estimated 8 million filings annually that are expected to come before our Federal and state courts this year.

Businesses should be encouraged to foster the creation of private courts, because their use could provide significant benefits to them. For example, although private courts would apply established law (which is, at times, unfortunately marred by an anti-business bias), there is almost no chance that the private judge would create a new judicial doctrine out of whole cloth. In addition there would be no judicial fiats that would shock business defendants and favor "small plaintiffs."

Perhaps a more significant plus for businesses would be the absence of juries in the

new private system. Juries typically tend to disfavor businesses over non-business parties. This is especially true when the business is not based in the region where the court is sitting. Judges, as finders of fact, are presumably more sophisticated than juries and less likely to be burdened by a jury's typical prejudices.

However, the strong incentives to erect a comprehensive private judiciary may be offset by disincentives arising from the would-be legal entrepreneurs' fears that any investment made in this field may be lost. Business people seem vaguely apprehensive that some future legislative backlash may occur, incited by "public interest" groups' exaggerated emphasis on the negative policy implications of a private judiciary.

It is true that privatization of the judiciary will not happen without costs. The real costs, however, are not those to which such interest groups would likely object. Highly qualified judges, already being tempted away from their low-salaried positions on the bench back to the private sector, would likely leave in greater numbers for work as private judges. This migration might further impoverish the pool of legal thinkers in the publicly financed judiciary, thereby leaving behind both less skilled jurists and the type of activist judges for whom there would be no demand in the private sector.

Another perceived cost of privatization, assuming the demand for dispute resolution does not rise in response to decreased costs, is the reduction in the number of billable hours that firms can expect to generate. The costs to the legal profession may here be directly inverse to the benefits clients receive. Accordingly, the legal establishment may be reluctant to endorse privatization. (The American Bar Association has taken no position on the trend as yet.)

However, in this respect it is certain that businesses involved in private dispute resolution would gain. Alan Epstein, president of Judicate, insists that any loss to a firm in billable hours will be offset by an increased capacity to take on cases, as well as by a happier group of clients.

Cases with profound social policy implications will inevitably continue to be brought in the public courts. Nevertheless, it seems likely that legislatures will eventually be persuaded that the greater dispensation of justice (in terms of speedier proceedings and the higher real awards that would result) outweighs any potential impoverishment of the public judiciary.

In sum, the policy question at the core of any future debate concerning whether a private judiciary should be allowed to exist is whether the public judiciary could profit by a little competition to its status as the primary organ of dispute resolution. Given the current crisis, the answer should be in the affirmative. □

John Bright: Voice of Victorian Liberalism

by Nick Elliott

John Bright did more than anyone else to bring about the great advances for liberty in nineteenth-century Britain. A leading orator and agitator, he was considered by many to be the best political speaker of the century. His voice contained a quiet passion which captivated fellow members of Parliament and roused the many thousands he addressed at public meetings.

Born in Rochdale (a town north of Manchester) in 1811, Bright was raised in the individualistic tradition of the Society of Friends. From the faith of his family, he learned that there is a natural equality of mankind, and that any individual can communicate with God. He later recognized this connection between his religion and his politics:

> We have no creed which monarchs and statesmen and high priests have written out for us. Our creed, so far as we comprehend it, comes pure and direct from the New Testament. We have no thirty-seven articles to declare that it is lawful for Christian men, at the command of the civil magistrate, to wear weapons and to serve in wars.[1]

For many years Nonconformists—those who did not conform to the established Church of England—had been persecuted and forced to finance the state church. Because of this, they also tended toward political individualism. John's father, Jacob Bright, was liberal in his politics, and a supporter of the radical Member of Parliament Joseph Hume. He was also one of the many Nonconformists who refused to pay the church rate—a local tax to finance the state religion—and as a result had silver spoons taken from his house by church officials.

As a young man, John worked in his father's cotton mill. He kept a collection of books in a room above the counting house, and in spare moments went there to expand his knowledge. His favorite writer was the poet and liberal scholar John Milton. At the same time, John was tutored in politics by his fellow workers, supporters of the Chartist movement, which called for universal male suffrage and the elimination of property qualifications for members of Parliament.

Bright established his reputation in an 1840 debate over church rates, an issue close to his heart. In his hometown of Rochdale, he led a rebellion against the local vicar. A large gathering was held in the local churchyard, at which John mounted a tombstone to denounce the "foul connection" of church and state.

The Campaign Against the Corn Laws

Bright is most famous for his part in the successful campaign for the repeal of the corn laws. During the Napoleonic War, English landowners had enjoyed a monopoly in the production of food. At the end of the war, they instituted the corn laws—a form of import control—to protect their domestic monopoly

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from competition. The laws kept the price of grain high, and since bread was the primary sustenance for most families, the laws created particular hardship for the poor. The issue had been brewing for some time. Charles Villiers had proposed corn law repeal in Parliament every year, and the Anti-Corn Law League was formed in Manchester in 1839. Richard Cobden and John Bright were instrumental in its founding.

The campaign gathered impetus in the "hungry forties" with a succession of poor harvests. The poverty was very real—observers reported seeing people with "withered limbs" in Manchester. Cobden was elected to Parliament from Stockport, and Bright was elected in 1843 to represent Durham. The League developed into a highly efficient political machine with mass support. They distributed millions of leaflets, held gatherings up and down the country, and published their own newspaper, *The League*. In addition, they gained the support of the fledgling *Economist*. In 1845, when Ireland was struck by a potato blight, pressure for repeal grew even stronger.

Bright and Cobden embarked upon a hectic speaking tour. The climax was a meeting in the Covent Garden Theatre, where Bright railed against the protectors of upper class privilege: "The law is, in fact a law of the most ingeniously malignant character. . . . The most demoniacal ingenuity could not have invented a scheme more calculated to bring millions of the working classes of this country to a state of pauperism, suffering, discontent, and insubordination. . . . "[2]

Leading Whigs and Tories were convinced of the need for repeal, and on June 25, 1846, a bill for repeal was carried. The elimination of other import duties followed, and a 70-year era of British free trade began; in the popular mind, free trade now signified cheap bread.

The event was also a momentous one for the landscape of British politics. Division in the Tories was irreconcilable. The landowning interests had stubbornly resisted repeal, and Prime Minister Robert Peel, who had supported repeal, was forced to resign. The division excluded the conservatives from government for the next twenty years.

In his activity in support of free trade, Bright was motivated above all by a concern for the plight of ordinary people. From the same motive, he opposed all the legislation which regulated working conditions in factories. The Factory Act of 1847 was in part a retaliation by the landowners for the corn law repeal: regulation of factories was a means of penalizing manufacturers. Bright was certain that it would make people worse off by reducing the number of hours in which they could earn money.

Opposition to the Crimean War

In their campaign against the corn laws, Bright and Cobden rode a wave of public adoration. But in their opposition to the Crimean War, the contrast could not have been greater, for they had to endure derision from a jingoistic public. Despite this, they produced some of the most lucid statements of non-interventionist foreign policy ever made, and Bright contributed some of his most memorable oratory.

For Bright, Cobden, and other leaders of the "Manchester School," free trade was inseparable from a pacific foreign policy. Trade is based on mutual cooperation, and evokes goodwill among nations. They rejected the argument that foreign alliances were needed to enforce a "balance of power" in Europe, and warned that such alliances would drag Britain into future conflicts. The only people who would benefit from war were the "tax-eating" class—government bureaucrats. Common people would suffer from the burden of taxes to fund foreign adventures. Bright and Cobden reserved no cordiality for Liberal Party Prime Minister Palmerston, a notorious interventionist whose policies attracted the description of "gun-boat diplomacy."

As the war continued, Bright became deeply distressed by the loss of life: 22,000 British soldiers died, but only 4000 in action; the rest died from malnutrition, exposure, and disease. His passionate speeches left a lasting impression on the House of Commons. His most famous words were these:

> The Angel of Death has been abroad throughout the land; you may almost hear the

beating of his wings. There is no one, as when the first-born were slain of old, to sprinkle with blood the lintel and the two sideposts of our doors, that he may spare and pass on; he takes his victims from the castle of the noble, the mansion of the wealthy, and the cottage of the poor and lowly.[3]

India and the American Civil War

At the end of the Crimean War, Bright suffered a nervous collapse, and was unseated in the general election. However, it was not long before he was returned as member for Birmingham, and with renewed energy he sought better government for India. Bright argued that the mutiny of 1857 was caused by the ineptitude of colonial government. Capable Indians were excluded from the administration of their own country, positions being allocated instead by personal favor. Bright assailed the economic management which imposed onerous taxes on the Indian peasantry, stunting development to maintain a vast, inefficient Indian civil service. He was ahead of his time in recognizing that Britain would not rule India forever. He also saw the potential for conflict in a country of "twenty nations, speaking twenty different languages," and argued for a confederacy of smaller states.

For many years, Bright had been an admirer of the United States—he was sometimes known in the House of Commons as the Honourable Member for the United States. He thought that the free and democratic style of government in America should be a model for Britain. When civil war erupted, Bright was concerned for the future of the republic, but allied himself with the cause of the North.

English liberals weren't unanimous in supporting the North. Cobden initially inclined toward the South, and *The Economist* sympathized with the South throughout. A humanitarian always, Bright supported the North because of the issue of slavery, which appalled him. In the early part of the war, when military intervention on the side of the South seemed likely, Bright urged neutrality. He also maintained a correspondence with the Chairman of the Senate Foreign Relations Committee, Charles Sumner. He encouraged caution and diplomacy; some of the letters he wrote to Sumner were read to President Lincoln.

It was always a matter of regret for Bright that he never visited North America. He maintained his admiration for the United States, and saw in it the potential of a great world power.

Parliamentary Reform

Before 1867, only 16 per cent of British adult males had the right to vote. In the 1860s, Bright led a vigorous campaign for full manhood suffrage, secret ballots, and equal representation for industrial cities like Birmingham and Manchester.

He rested his case upon two principles. First, since working people must pay taxes and bear the impact of legislation, they should also have a voice in government. Second, he expressed faith in the decision-making ability of ordinary people. A frequent claim of reactionary conservatives was that common people are incapable of making important decisions. Bright reversed this and argued that progress had been achieved only by enforcing working class opinion. He was somewhat naive in supposing that a mass franchise would lead to low taxes, free trade, and a non-interventionist foreign policy.

With his ability to rouse passions, Bright's efforts in the campaign for electoral reform made him a formidable adversary of the Conservative government. Previous campaigns had often suffered from having the support of only one class, whereas Bright rallied the middle and working classes into unity. Ironically, in the same way as corn law repeal, reform was introduced by a Conservative prime minister. Benjamin Disraeli presided over the 1867 Reform Act, which enfranchised two million additional men, and cleared the way for later reforms.

Later Years: Cabinet and Ireland

As a parliamentary back-bencher, Bright had been enormously influential. Nearing the end of his campaigning career, he entered William Gladstone's cabinet in 1868. He never was happy in assuming collective responsibility,

and soon had cause to disagree with his government colleagues. The Forster Act of 1870 laid the foundations of state education, and it incorporated the teaching of state religion which was anathema to Bright. He wrote to Gladstone that it had done a "tremendous mischief" to the party.[4] After the 1880 election, Bright was again invited into government. Soon after, Britain initiated a war with Egypt, and Bright's objection was so great that he felt compelled to resign.

Ireland was another longstanding interest. Bright had been a personal friend of Irish reformer Daniel O'Connell, who had supported the Anti-Corn Law League. Bright took up the grievances of the Irish and, after O'Connell's death in 1847, was often their most persistent representative in Parliament. He rejected all attempts to impose the Church of England upon the native Catholics; instead he called for the withdrawal of this "symbol of conquest." The other issue was land policy: Irish agriculture had always been weak because large-scale English owners maintained idle lands, and because tenants scratched a precarious existence with no legal right of tenancy. Bright offered three solutions: an end to the law of primogeniture which ensured the continuation of concentrated ownership; compensation for evicted tenants and loans for those who wanted to buy land; and land purchase from English owners, to be sold at a discount to Irish buyers.

Some of these proposals were implemented, as Gladstone had been taking note of Bright's suggestions. But in Parliament the Irish Nationalist representatives became increasingly militant. They used disruptive techniques which led, in response, to the rules of procedure which still are with us today. Bright deplored all this, and it significantly changed his attitude. In 1886, Gladstone introduced a land purchase scheme to buy out the English landlords, along with a proposal for Irish home rule. By this time, Bright was so disgusted with the activities of the Nationalists in Parliament that he opposed the land purchase scheme, and he regarded home rule as a policy which would endanger the "Protestant and loyal people of the north."[5]

As a figure of importance among the Liberals, Bright's opposition was very damaging to Gladstone. Home rule was defeated, and the Liberals were hopelessly divided on the issue. It pained Bright to speak out against Gladstone because they had been good friends.

In an essay of this length, it isn't possible to describe all of Bright's arguments. He was also a committed opponent of capital punishment, spoke on many aspects of colonial government, and addressed a variety of issues involving religious freedom. His speeches are a pleasure to read, and one can imagine the impact they made upon listeners.

Bright lived from 1811 to 1889, and when looking at the political events during those years, the advance of liberal principles is quite momentous. In 1819, when demonstrators protested against the corn laws and the lack of parliamentary representation, they were cut down by a cavalry charge. As late as 1859, Queen Victoria expressed her concern to Lord Palmerston that John Bright was attempting to undermine British institutions. Yet by 1868, when Bright became the first Nonconformist to hold a cabinet post, he was respected, as were the principles he enunciated. In the campaign against the corn laws, he helped to establish free trade as a popular principle which no politician would dare to interfere with for years to come. His stand with Cobden against the Crimean War inspired a later generation of liberals to follow the idea of non-intervention. Opening up Parliament to the scrutiny of ordinary people marked an end to the high-handed government of earlier times. In these, as in many other issues, John Bright, as a consistent and principled defender of individual liberty, imparted a widespread and lasting acceptance of liberal politics. □

1. William Robertson, *The Life & Times of John Bright* (London: Fisher Unwin, 1912), p. 203.
2. Speech at Covent Garden Theatre, December 19, 1845, in J. E. Thorold Rogers (ed.), *Speeches on Questions of Public Policy* (London: Macmillan, 1878), pp. 419-420.
3. Speech to the House of Commons, February 23, 1855, in Rogers, p. 251.
4. Quoted in G. M. Trevelyan, *The Life of John Bright* (London: Constable, 1913), p. 409.
5. Quoted in Keith Robbins, *John Bright* (London: Routledge & Kegan Paul, 1979), p. 256.

The Scranton Story

by Burt Folsom

In the first few decades of the nineteenth century, the English dominated the world's iron markets. They had developed the first blast furnaces, invented the puddling techniques to purify molten iron, and had skilled workers eager to compete on a world market. With this large head start over U.S. producers, the English, by the 1830s, were providing all of America's iron rails, and all the cast-iron water pipes, as well as iron-tipped plows, locks, and nails. By 1840, dozens of Americans were experimenting with different types of fuels, ores, and blast furnaces, trying to produce American-made iron.

During the 1840s, in Pennsylvania's Lackawanna Valley, George Scranton, his brother Selden, and their cousin Joseph Scranton became the first Americans to mass-produce iron rails. Two things are striking about the Scrantons' success: First, the Lackawanna Valley, with its thinly scattered, low-quality ore deposits, was hardly a natural setting for manufacturing. Second, in the competition for urban growth, the winning city of Scranton did not exist until the 1840s. Nearby Wilkes-Barre and Carbondale had the advantages of age and wealth, until Scranton overcame them.

The migration of the visionary Scrantons to northeast Pennsylvania began in 1839, when William Henry, a trained geologist, scoured the area looking for the right ingredients for iron-making—water power, anthracite coal, iron ore, lime, and sulphur. He found these elements near Wilkes-Barre, the oldest, largest, and wealthiest city in northeast Pennsylvania. Wilkes-Barre's leaders, though, were cautious: they preferred to ship coal safely down the Susquehanna River, not to risk their fortunes on unproven iron. So Henry went about 20 miles east into the wilderness of the Lackawanna Valley, and looked over the land in this area. It had some water power and lots of anthracite; he also found small quantities of iron ore and lime, so he falsely assumed they existed there in abundance.

Playing a hunch, Henry took an option to buy 500 acres of land at present-day Scranton and built a blast furnace on it. At first he sought the necessary $20,000 for the scheme from New York and England; but the high risk of his daring experiment frightened away even the hardiest of speculators. Finding greater faith within his family, Henry received support from his son-in-law, Selden Scranton, and Scranton's brother George, both of whom were operating the nearby Oxford Iron Works in Oxford, New Jersey. Originally from Connecticut, the wide-ranging Scrantons tapped their credit lines and picked up additional capital from their first cousin, Joseph Scranton; his brother-in-law, Joseph C. Platt; and friends, Sanford Grant and John and James Blair, who were merchants and bankers in Belvidere, New Jersey. These entre-

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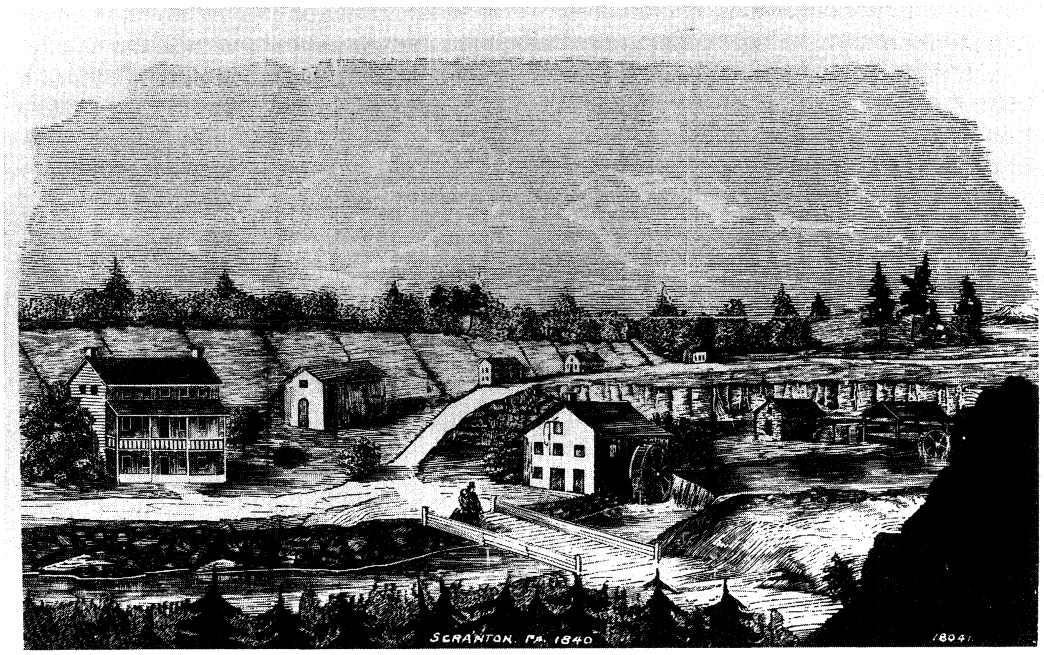


Scranton in 1840

Copy photography by Dorothy Allen from an original in the Lackawanna Historical Society Archives

preneurs, whom we will call the Scranton group, raised $20,000 in 1840 and spent the next two years building a blast furnace and digging the ore and coal to make iron.

Making iron, they quickly discovered, required more entrepreneurship than they had originally expected. The local ores and limestone were limited and of poor quality. They had chosen the wrong location, but it was too late to sell out and switch, so they searched eastern Pennsylvania and New Jersey for the right combination of ores and limestone.

Only the local coal lived up to expectations, and this was available in other areas with established cities closer to the lime and ore. When the Scrantons made their iron, they brought their lime and ore on boats from Danville, Pennsylvania, about 30 miles up the Susquehanna River right by the mansions on the River Common in Wilkes-Barre, and over land almost 20 miles to Scranton.

The high costs of transportation and the unexpected purchases of ore and lime almost ran the Scrantons into bankruptcy; then George Scranton came up with a plan to convert the pig-iron into nails. Such a bold venture into manufacturing would not be cheap. The need for a rolling mill and a nail factory upped the ante to $86,000. Desperate for credit, George Scranton coaxed some of this money from New Yorkers. Yet this jeopardized the family's ownership. So he placed his greatest reliance on other members of the Scranton group: longtime friends John and James Blair invested money from their bank in New Jersey, and Joseph Scranton sent funds from his mercantile business in Augusta, Georgia. By 1843, George Scranton got his $86,000, kept control within the family, and began making nails for markets throughout the East Coast.

The nail factory failed miserably. First, no rivers or rails helped market its product. Dependent on land transportation, the Scrantons transferred the nails on wagons east to Carbondale and west to the Susquehanna River, and from there shipped them to other markets. Second, no one wanted the Scrantons' nails because they were of poor quality. The low-grade ores in the Lackawanna Valley provided only brittle and easily breakable nails.

Faced with bankruptcy, the Scrantons contemplated the conversion of the nail mill into a rolling mill for railroad tracks. Experienced Englishmen still dominated the world production of rails in the 1840s; no American firm had dared to challenge them. After floundering in

the production of nails, however, the Scrantons decided that a lucrative rail contract might be the gamble that could restore their lost investment.

As luck would have it, in 1846, the nearby New York and Erie Railroad had a contract with the state of New York to build a rail line 130 miles from Port Jervis to Binghamton, New York. When Englishmen hesitated to supply the Erie with the needed rails, the Scrantons had their chance. They traveled to New York and boldly persuaded the board of directors of the New York and Erie to give their newly formed company the two-year contract for producing 12,000 tons of T-rails. They promised to supply rails more cheaply and quickly than the British. Impressed with the Scrantons and desperate for rails, the directors of the New York and Erie advanced $90,000 to the eager Scrantons to construct a rolling mill and to furnish the needed track.

The construction of the mill and the making of thousands of tons of rails seemed impossible. The contract called for the Scrantons to supply the Erie with rails in less than twenty months. The Scrantons first would have to learn how to make the rails they promised to provide. Building the blast furnaces would come next. Then they would have to import some ore and much limestone into the Lackawanna Valley to make the rails. Finally, because they lacked a water route to the Erie line, they would have to draft dozens of teams of horses to carry finished rails from their rolling mills scores of miles through the wilderness and up mountains to New York, where the track was to be laid. It is no wonder the New Yorkers wanted to back out at the last moment. Yet somehow, in less than a year and a half, the Scrantons did it. On December 27, 1848, just four days before the expiration of the Erie's charter, the Scrantons fulfilled their contract and completed the rail line.

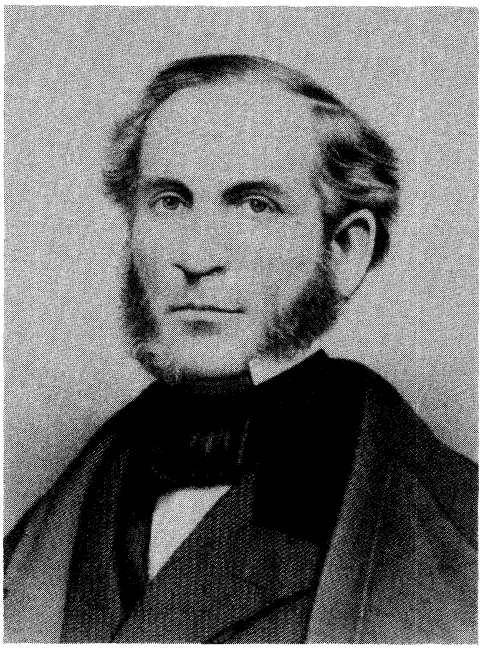
The Effect of Low Tariffs

An interesting feature of the Scrantons' achievement was that they built their rails during a time of low tariffs. Some businessmen have always argued that their government should place high tariffs on imports to protect local manufacturers against foreign competitors. Yet, in 1846, the year the Scrantons began making rails, Congress passed the Walker Tariff, which lowered duties on imported rails and other iron products from England. George Scranton said he actually liked the lower tariff for two reasons. First, the Scranton price of $65 per ton of rail was already fixed and was competitive with English prices. In any case, Scranton estimated his firm would be earning $20 per ton profit, so the tariff was not needed. Second, the low tariff meant that the Scrantons could buy their raw materials—pig iron, rolled bars, and hammered bars—more cheaply. This, Scranton hoped, would lay the foundation for his firm to be the strongest on the continent for years to come.

Many Americans were amazed that an iron works located in the middle of a wilderness, with no connecting links to outside markets, could build and deliver 130 miles of rails to a railroad in another state. The Scrantons did not want to have to duplicate this feat, so they did two things to improve their location: first, they started building a city around their iron works; second, they began building a railroad to connect their city to outside markets. That way they could ship rails anywhere in the country and also export the local anthracite, which could be sold as a home-heating fuel.

With the confidence of New York investors, the Scrantons proposed two railroads: the Liggett's Gap, and the Delaware and Cobb's Gap. The Liggett's Gap line, running from Scranton 56 miles north to connect with the Erie at Great Bend, would permit Scranton to supply coal to the farms in the Genesee Valley in upstate New York; the Delaware and Cobb's Gap route, running 64 miles east to the Delaware River at Stroudsburg, would give the Scrantons a potential outlet for coal to New York City. By backing two lines, the Scrantons gave themselves two markets for Lackawanna Valley coal. The building of a railroad, then, was a logical sequel to the Scrantons' superb iron works. The railroad itself became a market for Scranton iron; it provided an outlet for Scranton coal; and it promoted trade for Scranton city.

Building the two railroads was no cinch.



George Scranton, 1811-1861

Some of the terrain was mountainous: even after using gunpowder to level the hills, the grade was still steep in places. Also, George Scranton had to negotiate some delicate right-of-way problems with farmers who were overvaluing their land. Of course, the Scrantons were using their own homemade rails for the line, but this still ran into costs. For all of this, the Scrantons needed more New York capital, but they had to be careful. They wanted to be entrepreneurs, not pawns of the New Yorkers. The Scrantons had to make sure they retained a guiding interest in their projects. This they did.

The two railroads were surveyed and built between 1850 and 1853; they both were consolidated into one line, the Delaware, Lackawanna, and Western Railroad (hereafter Lackawanna Railroad) with George Scranton as its first president. In 1853, flushed with success, the Scrantons also incorporated their iron works as the Lackawanna Iron and Coal Company (hereafter Lackawanna Company) with $800,000 in stock; they elected Selden Scranton as president.

The building of America's premier iron works and railroad was an amazing feat of collective entrepreneurship. The Scranton group became unified behind a vision of mass-produced rails, the creating of a city, and the laying of rails from its borders east and north to outside markets. As individuals, the members of the Scranton group had few of the skills and little of the capital needed to fulfill this vision; but collectively they did. They had to have outside cash, but their confidence and unity of purpose impressed New York investors and convinced them the Scrantons could do the job.

Not everyone wished the Scrantons well. And this made their success story even more remarkable. First, there was the generally negative reaction from leaders in Wilkes-Barre, who thought the rise of a new city would threaten their hegemony in northeast Pennsylvania. The Scrantons logically tried to secure loans in Wilkes-Barre, the oldest and largest city in the area. But the businessmen there rarely helped, and they often hurt. For example, in the 1850s the Scrantons tried to get a charter for their railroad from the state legislature; Wilkes-Barre's politicians thwarted the Scrantons because the new rail line threatened Wilkes-Barre's trade dominance along the Susquehanna River through the North Branch Canal.

Not only did politicians in Wilkes-Barre hamper iron production and delay rail completion, they prevented the Scrantons' emerging industrial city from becoming a county seat. The new city of Scranton happened to be situated in the eastern end of Luzerne County. But wily politicians in the county seat of Wilkes-Barre used state-wide influence to delay for decades the creation of a new county. Even the prestige and influence of George Scranton in the Pennsylvania Senate and U.S. Congress during the 1850s could not force the division of Luzerne County. So while the Scrantons were trying to promote their new town as a center of industrial opportunity, the town's administrative business was being diverted to the county seat of Wilkes-Barre.

Possibly even more damaging than the opposition from Wilkes-Barre's politicians was the hostility of many farmers near Scranton. These old settlers liked the prospects of improved transportation to get their crops to market, but many did not want to see industrialization transform their rustic community. Even before the Scrantons arrived, several of these farmers had formed a committee to denounce them.

The squabbles with the old settlers regularly

kept the Scrantons from fully attending to their iron works. Recognizing this problem early, the Scrantons donated land and labor to help build them a church. Through a company store, the industrialists enthusiastically traded goods and produce with nearby farmers. Desperate for credit, though, the Scrantons were barely surviving in the early 1840s and had to seek extensions on local loans.

Disputes with the old settlers over land and credit persisted as the Scrantons verged for years on bankruptcy without successfully producing nails or rails. Feuding seems to have been commonplace. Even when the Scrantons finally received the rail contract from the Erie, many farmers withheld the use of their mules and horses to prevent delivery of the rails; others charged exorbitant prices. Under these conditions, one can hardly argue that the location of Scranton was inevitably destined for urban glory.

Promoting a New City

When the iron works and the railroad succeeded, the Scrantons then promoted the growth of their new city. Their correspondence shows that they clearly viewed industrial and urban growth as symbiotic. Their investment in real estate and housing multiplied in value after the success of their iron works and the arrival of a railroad. The Scranton group originally bought a 500-acre tract for $8,000 in 1840. As mere coal land that acreage was worth at least $400,000 by the mid-1850s. As improved land much of it was worth even more. The Scrantons had laid out streets, sold lots, and built mansions for themselves and company houses for their workers.

Unlike the leaders in Wilkes-Barre and Carbondale, the Scranton group created an open environment for their city and actively recruited investors to come. To do this effectively, they went to the state legislature in 1866 and secured wide city limits of almost twenty square miles, which at that time included mostly farm and timberland. They incorporated this large space to fulfill their vision of their city's future, in which they saw many more industries, homes, and parks. The space was needed to plan all this properly.

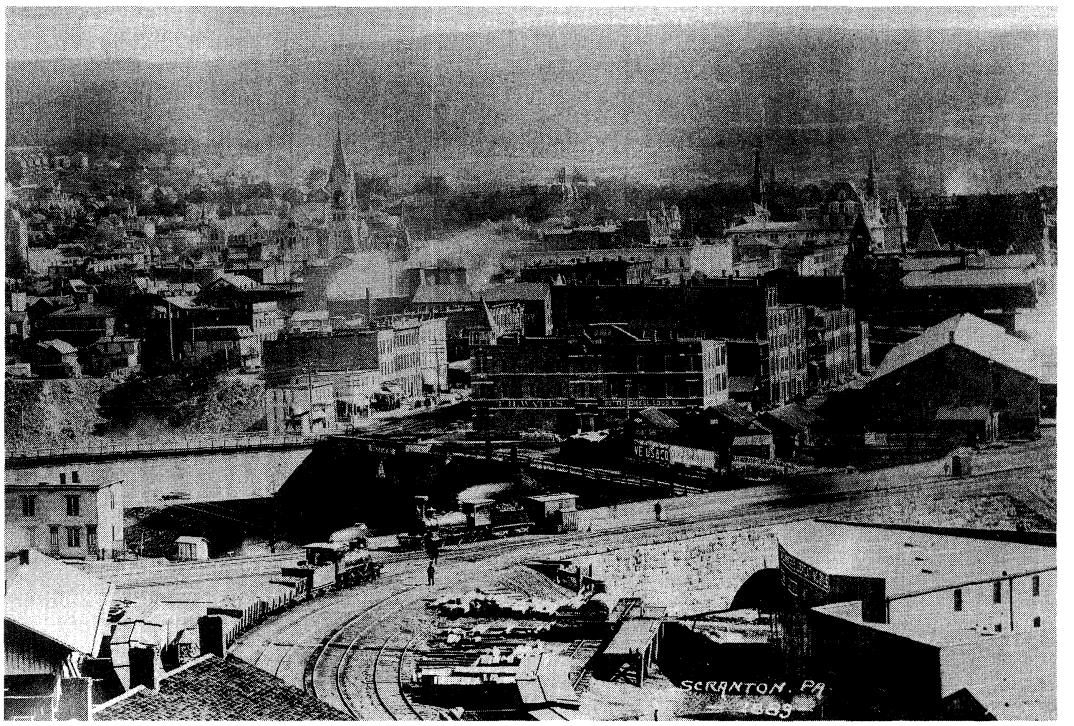
Wilkes-Barre's leaders, by contrast, wanted to limit immigration and preserve their closed society. They intentionally settled for small city limits of 4.14 square miles and did not even incorporate this much land until five years after the Scrantons did so. This made urban planning in Wilkes-Barre difficult, and it also hindered the preventing of fires and the controlling of epidemics.

All this creates the impression that, once the iron works and the railroad were established, and once the city of Scranton was incorporated, the Scranton group had it made. But this was not the case; in fact, most of the Scranton group did not die rich, and two died very poor.

William Henry, the original leader of the group, left the city in the 1840s after some bad investments. Henry had energy and vision but little patience and endurance; he died embittered and impoverished in 1878. Sanford Grant, the first owner of the company store, wilted when faced with business competition and industrial risk. Selling his stock, he left for safer business climes in Belvidere, New Jersey, where he lived, without ulcers or wealth, until his death in the 1880s. Displaying greater fortitude than Grant, Selden Scranton became the first president of the Lackawanna Company; five years later, though, he and his brother Charles left to operate a blast furnace in Oxford, New Jersey. Their ironmaking talents ultimately failed them; Seldon declared bankruptcy in 1884 and died shortly thereafter.

George Scranton, the early leader and driving force behind coal and railroad development, had more faith and perseverance than most of the others. He amassed $200,000, built a fine mansion, and served as U.S. Congressman from northeast Pennsylvania. George, however, still lost some of his fortune during the Panic of 1857 and had to sell much of his stock in the Lackawanna Railroad at reduced value. Plagued with health problems from overwork during the rugged days of the 1840s, George died in 1861 at age 49.

Three other members of the Scranton group never abandoned their vision of manufacturing rails and building a city; they achieved fabulous success and wealth. On top was Joseph Scranton, who said at the start, "I have no fears of the ultimate success [of the iron works]



Scranton in 1883

Copy photography by Dorothy Allen from an original in the Lackawanna Historical Society Archives

. . . I have invested in it. Should remain till it is doubled or lost as the case may be." Twenty-seven years later, Scranton was president of the flourishing Lackawanna Iron and Coal Company and was worth $1,100,000, making him the wealthiest man in northeast Pennsylvania. His brother-in-law and next-door neighbor, Joseph C. Platt, was superintendent of the Lackawanna Company and was worth $220,000. Right behind Joseph Scranton with $910,000 was his friend James Blair, who had backed the Scrantons from nails to rails. Blair held a substantial amount of stock in both the iron works and the railroad; he then expanded and started Scranton's first trolley company.

Some people point to such wealth, and the absence of it in other households, and argue that the state should redistribute it, or at least tax it at high rates. It hardly seems fair, they might say, that some people should have so little, while three men—Joseph Scranton, Joseph Platt, and James Blair—should own close to ten per cent of all the wealth in the city (according to the data in the 1870 Federal census). What we need, according to this view, is an active state to transfer income, chop up inheritances, perhaps even to impose equality of condition.

To argue this way is to miss a key point: Scranton's founders, as entrepreneurs, created something out of nothing. They created their assets and created opportunities for others when they successfully bore the risks of making America's first iron rails. Without them, almost everybody else in the region would have been poorer. The amount of wealth in a region (or a country) is not fixed; in 1870, Scranton, Platt, and Blair got the biggest piece of the economic pie, but it was the biggest piece of a much larger pie—made so by what they did when they came to Pennsylvania 30 years earlier.

When the Scrantons came to the Lackawanna Valley, it was a poor farming region with no close ties to outside markets. In 1850, according to the Federal census, no one in the Lackawanna Valley was worth more than $10,000. In 1870, after the Scrantons had established their city and their iron works, 33 families in Scranton alone were worth at least $100,000; and one was already a millionaire. Thousands of other families were working their way toward better lives. The Scrantons' iron

works and railroad were the means to this end.

Some people look at the results of splendid entrepreneurship and say that someone else might have come along later and done the same thing. We can see how improbable this is in the Scranton case. The wealthy leaders in the older, more prosperous city of Wilkes-Barre, for example, shunned manufacturing for years and often tried to thwart the Scranton's plans. If the Scrantons had not come along, much of the iron ore in central Pennsylvania and New Jersey probably would have been exported to Philadelphia, Pittsburgh, or New York, where more abundant capital eventually would have taken the risks of making manufactured goods. Northeast Pennsylvania would have been left in the dark.

To be sure, the anthracite in the Lackawanna Valley was already attracting New York investors: but they came only to get coal, not to build cities and make the region prosper. Without dedicated local entrepreneurs, the Lackawanna Valley, like so many mining regions, would have enjoyed only fleeting and limited prosperity. The entrepreneurs in New York would have bought the coal land cheap, supplied transportation to the region, collected their profits, and left the exporting area full of deserted mines and ghost towns.

Creating Opportunities

Let's look at the different opportunities the Scrantons, as entrepreneurs, created for others. First, the people in northeast Pennsylvania, especially those with capital to invest, now had new and better opportunities available. Scranton, in fact, became a magnet for entrepreneurs in nearby towns, except for Wilkes-Barre. Investors in the nearby county seats of Montrose and Towanda came to Scranton and set up the city's first two banks. From nearby Honesdale came Scranton's first large-scale flour miller. From Carbondale came the presidents of both of that city's banks, a locomotive builder, a stove maker, a coal operator, and the mayor. Not all of these men won fortunes, but several did, and their investments helped diversify Scranton's economy and made it one of the fastest growing cities in America in the late 1800s.

Another group of winners were the many local farmers who held on to their land and sold it later as coal land. All they had to do was watch others do the work of establishing the region's export. After this, they cashed in. The Scrantons bore the risks of making rails from imported ore; then they risked building a railroad to connect the Lackawanna Valley to New York City. All the farmers had to do was keep their land and watch it rise in value—from $15 an acre in 1840 to $800 an acre in 1857. In just 17 years, then, a 160-acre farm increased in worth from $2,400 to $128,000. Some of these locals even ended up richer than the wealthiest of the Scrantons.

Even the poorest immigrants sometimes got rich in Scranton. The growth of Scranton from a farming hamlet in 1840 to 45,000 people in 1880 brought thousands of immigrants to town. Many of them worked in the factories and improved their lives; they saved a little money and bought their own homes. Some of them had the talent and vision to rise to the top. In 1880, of Scranton's 40 most prominent businessmen, measured by memberships on boards of directors, nine were immigrants.

Some of these rags-to-riches immigrants were clearly among the most successful men in Scranton. Thomas Dickson, for example, came to America from Scotland and began work as a mule driver. Soon he was making engines, boilers, and locomotives for the Scrantons; he ended up as president of the Delaware and Hudson Railroad. Another immigrant, John Jermyn, came to Scranton in 1847 from England and began working for the Scrantons for 75 cents a day. Soon he was managing coal mines and was putting what little money he earned into coal land and real estate with a knack that amazed everyone. The critical risk in his career came in 1862, when he leased some abandoned mines northeast of Scranton. Defying the skeptics, Jermyn bought new machines and fulfilled a contract for one million tons of coal. He then tripled his contract and was on his way to becoming the largest independent coal operator in the Lackawanna Valley.

Because of the Scrantons, thousands of Americans had new opportunities in life. If they could just capture the Scrantons' vision,

they had a chance to succeed. One life that was made anew was that of Joseph J. Albright, the uncle of Selden Scranton. Albright was in business near Nazareth, Pennsylvania, and went bankrupt in 1850, when he was nearly 40 years old. He had to sell all his furniture at a sheriff's sale and deal with creditors from two states.

The Scranton group came to Albright's rescue and gave him a job as coal agent for their railroad. Soon Albright caught the Scrantons' vision. He was patient and invested wisely: he bought stock in the Scrantons' iron and coal company; he then joined them in building the city's gas and water system. On his own, he invested in a company to mill flour and in a firm to make locomotives. By 1872, he was worth half a million dollars and was elected president of the largest bank in the city. He had become a believer in Scranton and wanted to help the city that had given him a chance; when he died he deeded his home to the city and gave $125,000 to build a major public library.

Not everyone joined the Scranton team. Phillip Walter, another relative from Nazareth, resisted an elaborate courtship by the Scrantons in 1852. He told them he was reluctant "to pull [up] stakes and move" from "my long cherished home" because "I might fail." Winnowing out the conservative and the weak at heart, Scranton seems to have attracted a select set of venturesome leaders to guide its industrial growth.

Fostering an Open Environment

In building their city, the Scrantons consciously promoted entrepreneurship. The securing of wide city limits was part of this effort. They believed their city would grow, and they diligently planned its expansion. Along these lines, the Scrantons and their allies established a board of trade in 1867 to promote the industrial development of their city. They installed an innovative Welsh immigrant, Lewis Pughe, as the board's first president. The board actively recruited industry and even secured a law granting all new corporations tax-free status for their first ten years in Scranton.

In this open environment, Scranton grew as a manufacturing center and attracted many capitalists who were willing to take different types of risks. This made for a combination of inventiveness and creative entrepreneurship. For example, Henry Boies came to Scranton from New York in 1865 and founded the successful Moosic Powder Company; then he perfected a gunpowder cartridge that reduced the death and injury resulting from carelessness in mining explosions. Boies seemed to court risky ventures and had failed twice before coming to Scranton. Once he had made his fortune in powder, the credit lines were open, and he went to work inventing a flexible steel wheel for locomotives. He started the Boies Steel Wheel Company in 1888 to manufacture his patented invention.

Another innovation that succeeded in Scranton was Charles S. Woolworth's five-and-ten-cent store. Born in upstate New York, Woolworth, his brother Frank, and partner, Fred M. Kirby, experimented in the late 1870s with the opening of specialty stores featuring largely five-and-ten-cent merchandise. Shoppers were often skeptical of the first stores opened in Harrisburg, Lancaster, and York, Pennsylvania. In 1880, however, when Charles Woolworth set up a five-and-ten-cent store in Scranton, the idea caught on. Sales in Scranton were a modest $9,000 the first year, but the Woolworths and Kirby had laid the foundation for an empire, and Charles had found himself a new home in Scranton. A decade of brisk sales in Scranton encouraged Woolworth to start branch stores in New York and Maine in the 1890s. Kirby, meanwhile, started a profitable store in Wilkes-Barre. Soon Woolworths was selling nationally, and became a major American corporation. In Scranton, Woolworth joined with other local entrepreneurs in founding the International Textbook Company, which employed thousands of people to sell textbooks throughout the nation.

The introduction of electricity in the 1880s brought out the best in Scranton's entrepreneurs. They didn't produce Thomas Edison, but they did have Merle J. Wightman, who designed and built one of the first electric motors to run trolley cars. Scranton became one of the first cities in the nation to have an electric

trolley system. Other Scrantonians adapted electricity to coal mining. In 1894, they founded the Scranton Electric Construction Company, which perfected and manufactured electrical apparatus (e.g., mechanical drills, locomotive hoists, and mining pumps) for use throughout the anthracite coal fields.

Scranton did not emerge inevitably as a center for manufacturing trolley motors, locomotive wheels, or textbooks. Nor was there any particular reason why Scranton should have become a major headquarters for directing a chain of five-and-ten-cent stores. Other cities throughout America had the location and transportation facilities needed for these industries. Even the making and distributing of electrical mining equipment could have been done in Wilkes-Barre or in anthracite towns other than Scranton. A key to Scranton's success seems to have been the presence of aggressive entrepreneurs, who had a philosophy of openness and a commitment to growth. As the spiral of growth in industries, services, and population persisted, the city of Scranton, which was founded on a hunch, became one of the 40 largest cities in the country by 1900.

A lot can be learned from the story of the Scrantons. The first lesson is that entrepreneurs are needed to create wealth; when they succeed, others then have the chance to build on what they started. If we look at the later history of Scranton, we also can learn a second lesson: that it is hard for those on top to stay there in the generations that follow. An inheritance can be transferred; but entrepreneurship, talent, and vision cannot be. The industrial city of Scranton saw lots of movement down the ladder of social mobility, as well as up.

This can be seen if we look at what happened to the Scranton economic elite of 1880—those men who made up the first generation of the city's industrial leadership. I collected data on the 40 men in Scranton who, by 1880, held the largest numbers of corporate directorships and major partnerships. These 40 men dominated all of Scranton's major industries. Several were millionaires; and all had access to credit and contracts, which seemingly should have insured the success of their children in Scranton, which spiraled in population from 45,000 in 1880 to 137,000 in 1920.

As founders and developers of the Scrantons' vision, these forty entrepreneurs had much to give their children. Blessed by the luck of the draw, these fortunate offspring could choose almost any career, with the security that only wealth can bring. Raised in Victorian mansions rife with servants, they often had doting parents to give them private-school education, college if they wanted, or specialized training in engineering or industry. If these children did not prosper, they could fall back on hefty inheritances. Also, as they matured, they could take advantage of Scranton's thriving marketplace to make even more money. By 1920, the sons of Scranton's 1880 leaders had ample opportunity to succeed their fathers as the pacesetters of Scranton's business world.

Fathers and Sons

Yet they did not. Few went hungry, but most could not come close to matching their fathers' achievements. Only nine of the forty economic leaders in 1880 had even one son, son-in-law, or grandson who 40 years later was an officer of even one corporation in Scranton. In short, the fathers and sons provide a stunning contrast.

Why the sons did so poorly is complicated. Some of the reasons for this startling breakdown lie in the general problem of family continuity. Six families didn't have any sons; seven others had too many—which splintered the family wealth into small pieces. In a very few cases, some sons left Scranton for business ventures elsewhere. Often the sons chose not to go into business: they led lives of brief and precarious leisure.

The fragmentation of some of Scranton's larger family fortunes seems remarkable. For example, brothers Thomas and George Dickson between them held the positions of president of a national railroad, president of the largest manufacturing company in northeast Pennsylvania, president of an iron company in New York, and vice president of the largest bank in Scranton, as well as directorships of many large companies. Yet only one of Thomas Dickson's three sons went into business; and, under his leadership, the Dickson Manufacturing Company went out of business. George

Dickson's only child, Walter, became a salesman and held no corporate influence. The four sons of multimillionaire James Blair were nonentities. Only one of Blair's sons appears to have been gainfully employed, and his job was that of assistant cashier in his father's bank.

Even the Scrantons of Scranton were almost extinguished. George, Selden, and Joseph Scranton were the founding fathers of American rail making, but only one of their sons showed entrepreneurial skill. Selden was childless, and went bankrupt in any case. George was worth $200,000 when he died; but his sons, James and Arthur, became men of leisure, not entrepreneurs.

Joseph's son William gave business a try, but his story was often sad. Joseph was president of the Lackawanna Iron and Coal Company from 1858 until his death in 1872. But during these years, the New Yorkers bought up so much stock that William was not allowed to succeed his father as company president. Young William was restless as a mere local manager, so he studied the new Bessemer process in Europe and returned to start his own Scranton Steel Company in 1881. The city's low tax on new industries gave him an edge over the larger Lackawanna Company, but the older company won the competition and absorbed his enterprise in 1891. William did prove to be a very capable builder and operator of the Scranton Gas and Water Company. He and his son, Worthington, ran this company profitably and, in 1928, Worthington sold it for $25 million.

Dissolution and Decline

Some of the sons of Scranton's early industrialists literally squandered fortunes. Benjamin Throop, an early settler, had become a millionaire in coal land and urban real estate. His surviving son had, at best, modest business skills, and when he and his wife died prematurely in 1894, the 83-year-old Throop undertook the task of rearing his only grandchild, five-year-old Benjamin, Jr.

The elder Throop died shortly thereafter, but young "Benny" inherited a $10,000,000 fortune. Young Throop married into a prominent local family and, having no financial worries, served in World War I, but by that time his wife had divorced him and he seems to have lost any interest that he might have had in gainful employment or in the city of Scranton. During the 1920s, like a character from an F. Scott Fitzgerald novel, he spent most of his time in Paris indulging champagne tastes in cars and women. Throop died in 1935, in his mid-forties, of undisclosed stomach ailments, after apparently dissipating his grandfather's entire fortune.

Throop was a rare but not unique example of dissolution. Given the tradition of partible inheritance, many of the sons of economic leaders knew that they never would have to work, and so they became men of leisure with no business interests.

Passing the Torch

Of course, not all of Scranton's early industrialists had downwardly mobile sons. Nine of the 40 top capitalists in the Scranton of 1880 had passed the torch of leadership from father to son by 1920. In any randomly selected group of forty families, of course, some would produce sons or have sons-in-law with a flair for business. It is improbable, however, that nine of forty randomly chosen families would have corporate officers as sons. This merely shows that industrial leaders are much more likely than other groups in the population to father corporate officers. It does not show continuity of economic leadership because more than three-fourths of the industrial families of 1880 in Scranton failed to continue a line of corporate succession in the following generation.

While most of the sons of entrepreneurs stumbled, a variety of new immigrants in Scranton saw their opportunities and took them. By 1920, for example, Andrew Casey, an Irish liquor dealer, had become a bank president and a hotel magnate. Michael Bosak, a Slovak immigrant who started life as a breaker boy in the 1880s, owned banks, a manufacturing company, and a real estate firm in Scranton in 1920. Few had the talent and vision to build such empires, but those who did picked up where the city's founders had left off.

Scranton, in a sense, was America's first

manufacturing city. It marked the spot where America began to gain its independence from British iron. During the next generation, Scranton became a showcase of remarkable entrepreneurship and industrial growth. In this relatively open environment, Scranton's economic order was fluid: upward mobility for the poor existed side-by-side with downward mobility for the rich. Entrepreneurs were prized possessions for cities and for the nation; but their vision, talent, and drive were hard to transfer from generation to generation. Most of the families of Scranton's early industrialists died out as entrepreneurs; they didn't inherit their fathers' vision and turned over the city's economic leadership to newcomers.

And so the cycle goes—which means that if Scranton is typical, then two seemingly contradictory generalizations about the rise of big business are both true. First, a small constantly changing group of entrepreneurs consistently held a large share of the nation's wealth. Second, the poor didn't get poorer, and the rich didn't get richer either. □

IDEAS ON LIBERTY

Competition

It is often affirmed, and it is true, that competition tends to disperse society over a wide range of unequal conditions. Competition develops all powers that exist according to their measure and degree. The more intense competition is, the more thoroughly are all the forces developed. If, then, there is liberty, the results can not be equal; they must correspond to the forces. Liberty of development and equality of result are therefore diametrically opposed to each other. If a group of men start on equal conditions, and compete in a common enterprise, the results which they attain must differ according to inherited powers, early advantages of training, personal courage, energy, enterprise, perseverance, good sense, etc., etc. Since these things differ through a wide range, and since their combinations may vary through a wide range, it is possible that the results may vary through a wide scale of degrees. Moreover, the more intense the competition, the greater are the prizes of success and the heavier are the penalties of failure. This is illustrated in the competition of a large city as compared with that of a small one. Competition can no more be done away with than gravitation. Its incidence can be changed. We can adopt as a social policy, "Woe to the successful!" We can take the prizes away from the successful and give them to the unsuccessful. It seems clear that there would soon be no prizes at all, but that inference is not universally accepted. In any event, it is plain that we have not got rid of competition—*i.e.*, of the struggle for existence and the competition of life. We have only decided that, if we cannot all have equally, we will all have nothing.

Competition does not guarantee results corresponding with merit, because hereditary conditions and good and bad fortune are always intermingled with merit, but competition secures to merit all the chances it can enjoy under circumstances for which none of one's fellowmen are to blame.

—WILLIAM GRAHAM SUMNER

Booker T. Washington: Apostle of Freedom

by Robert A. Peterson

"Political activity alone cannot make a man free. Back of the ballot, he must have property, industry, skill, economy, intelligence, and character."

These words were spoken by a man raised in slavery. Yet in this man's philosophy lies the key to freedom. His name: Booker T. Washington.

Born in 1856 in Franklin County, Virginia, Booker Taliaferro Washington spent his earliest years as a slave. Of his father he knew nothing. "I do not even know his name," wrote Washington in his *Autobiography*. "Whoever he was, I never heard of his taking the least interest in me or providing in any way for my rearing." Yet he harbored no grudges. "He was simply another unfortunate victim," wrote Washington, "of the institution which the Nation unhappily had engrafted upon it at that time."[1]

When emancipation came, it was like a plunge into cold water: refreshing but sobering. Washington sensed the implications of freedom even as a small boy. In his *Autobiography* he wrote: "The wild rejoicing on the part of the emancipated coloured people lasted but for a brief period, for I noticed that by the time they returned to their cabins there was a change in their feelings. The great responsibility of being free, of having charge of themselves and their children, seemed to take possession of them. It was very much like suddenly turning a youth of ten or twelve years out into the world to provide for himself. In a few hours the great question with which the Anglo-Saxon race had been grappling for centuries had been thrown upon these people to be solved."[2] Washington early on recognized that freedom means responsibility as well as privilege.

Soon after emancipation, Washington and his family moved to Malden, West Virginia, where his stepfather worked in a salt furnace. Put to work beside his father, young Washington seemed destined for a life of drudgery. Yet he persuaded his parents to let him attend school before and after work. Following a regimen that would have killed someone with less determination, Washington seemed to run on adrenaline around the clock.

Washington soon outgrew the school at Malden. Hearing of the Hampton Institute in Virginia, where blacks could work their way through school, he set out at the age of sixteen with only a few dollars in his pocket. When he arrived, the teacher told him to sweep the room. Characteristically, he swept it three times and dusted it four. As he later said: "I had the feeling that in a large measure my future depended upon the impression I made upon the teacher in the cleaning of that room."[3] In at least one aspect, it was a more accurate assessment than any Scholastic Aptitude Test or Graduate Record Examination: it revealed character. After the teacher inspected

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TUSKEGEE UNIVERSITY

Booker T. Washington, 1856–1915

the room, she told Washington: "I guess you will do to enter this institution."

While at Hampton, Washington came into contact with a truly great man, Samuel T. Armstrong. Armstrong, a Northern general, dedicated himself to rebuilding the South through education when the war was over. Of him Washington wrote: "One might have removed from Hampton all the buildings, classrooms, teachers, and industries, and given the men and women there the opportunity of coming into daily contact with General Armstrong, and that alone would have been a liberal education. The older I grow, the more I am convinced that there is no education which one can get from books and costly apparatus that is equal to that which can be gotten from contact with great men and women. Instead of studying books so constantly, how I wish that our schools and colleges might learn to study men and things."[4] To pay his board, Washington worked as a janitor and a waiter. To fit himself for a trade, he studied masonry. So greatly did he impress the administration and trustees of Hampton that after graduation he was appointed as an instructor.

Meanwhile, at Tuskegee, Alabama, George Campbell, a white merchant, conceived the idea of a training school for blacks. When he wrote to Hampton for a suggestion for a principal, Booker T. Washington was recommended. Accepting the position, Washington arrived in Tuskegee only to find an old, worn-out field. The school itself was little more than a distant vision in Campbell's mind. But Washington caught that vision, and set to work laying the groundwork for what would become one of the nation's most unique schools.

Washington set up shop in a small church, sallying forth into the surrounding counties to look for prospective students. Eventually 30 students enrolled in Washington's Tuskegee Normal and Industrial Institute. Appropriately, the first term began on July 4, 1881. It was symbolic, for at Tuskegee poor blacks would get a chance to learn skills that would make them truly free—skills that would make them valuable members of the American economy. At Tuskegee, not only did every student study Western culture, every student had to work with his hands. "The individual who can do something that the world wants done will, in the end, make his way regardless of his race."[5]

During Tuskegee's formative years, Washington confronted deep-seated prejudice and misconceptions from both blacks and whites. Many whites felt that an educated Negro wouldn't work, while many blacks protested against making manual labor a part of the Institute program. Washington attacked these views by teaching that there is as much dignity in tilling a field as in writing a poem.

Private philanthropy made it possible for Washington to accept every student who came, regardless of whether he could pay. White citizens of Tuskegee made donations, as did poor blacks who lived in the area. As Washington's fame spread, and Tuskegee's along with it, some of the money from America's great captains of industry found its way to Tuskegee. Railroad magnate Collis P. Huntington gave over $50,000, while Andrew Carnegie donated enough to build a library, and later, a $600,000 gift. In making the latter gift, Carnegie wrote of Washington, "To me he seems one of the foremost of living men because his work is unique."[6]

The school was an unqualified success. As a pioneer of vocational education, Tuskegee paved the way for similar institutions for both blacks and whites. In 1908, Washington pointed out that "it was the Negro schools in large measure that pointed the way to the value of this kind of education."[7] At each commencement, visitors were pleased and amazed to see the graduates go through their paces. "I have never seen a commencement like Tuskegee's before," wrote Mary Church Terrell. "On the stage before our eyes students actually performed the work they had learned to do in school. They showed us how to build houses, how to paint them, how to estimate the cost of the necessary material and so on down the line."[8]

Soon other talented blacks began to gather around Booker T. Washington, including George Washington Carver. Calling his laboratory at Tuskegee "God's Little Workshop," Carver reduced the South's dependence on cotton, which depleted the soil, by finding over 300 uses for peanuts. Largely financed by the private sector, Carver's research gave a great boost to American agriculture.

Nonpolitical Solutions to the Problems of the South

In every area of life, Washington sought nonpolitical solutions to the problems of blacks and the South. Thus, instead of more Federal troops and more bureaucracy, Washington advocated private initiative. In his *Autobiography* he wrote:

> Though I was but a little more than a youth during the period of Reconstruction, I had the feeling that mistakes were being made, and that things would not remain in the condition that they were in then very long. I felt that the Reconstruction policy, so far as it related to my race, was in large measure on a false foundation, was artificial and forced. In many cases it seemed to me that the ignorance of my race was being used as a tool with which to punish the Southern white man by forcing the Negro into positions over the heads of the Southern whites. I felt that the Negro would be the one to suffer for this in the end. Besides, the general political agitation drew the attention of our people away from the more fundamental matters themselves in the industries at their doors and in securing property.[9]

So important was obtaining property in Washington's mind that he advocated property ownership rather than literacy as a test for the exercise of the franchise. Washington understood that without property, there could be no individual rights. Not black power, or white power, but "green power"—economic power—was the key to ending discrimination.

Washington had been tempted to enter political life, but reason eventually triumphed over expediency:

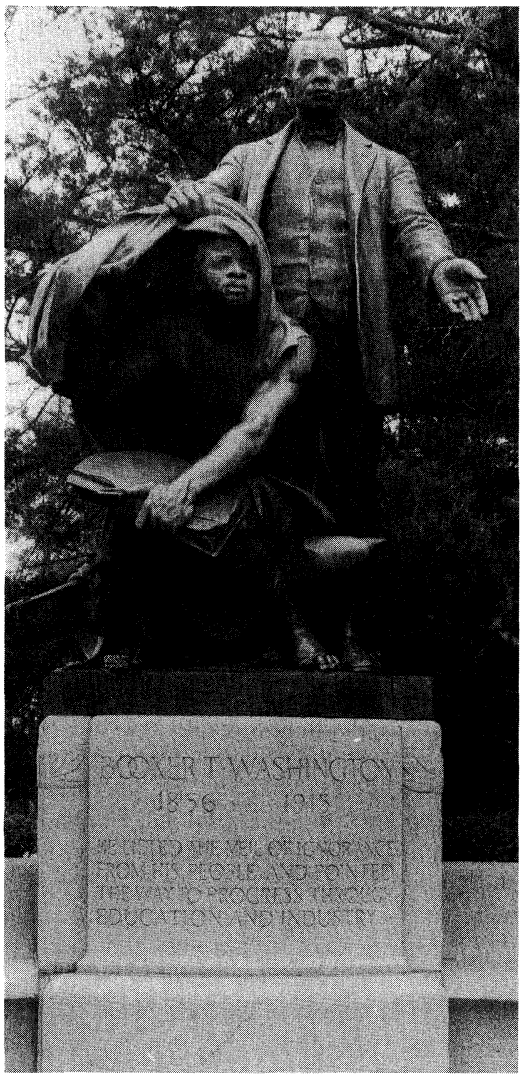
> The temptations to enter political life were so alluring that I came very near yielding to them at one time, but I was kept from doing so by the feeling that I would be helping in a more substantial way by assisting in the laying of the foundation of the race through a generous education of the hand, head, and heart. I saw colored men who were members of the state legislature, and county officers, who, in some cases, could not read or write, and whose morals were as weak as their education.[10]

This is not to say that Washington did not believe in political activity, for over the years he was instrumental in getting blacks appointed to important posts, including William H. Lewis as Assistant Attorney General and Robert Terrell as a municipal judge.[11] But he believed and acted upon the principle that no great movement can be effected from the top down, but that it must be built up from the ground floor. Before national victories could be won, victories had to be won at the grass roots.

This was the philosophy that Washington espoused when he was asked to speak at the Atlanta Exposition in 1895, the first time a black leader had been invited to speak to a large group of whites in the Deep South. Washington urged blacks to "cast down your bucket where you are" in agriculture, mechanics, and other fields, "and get to work." He then told the white audience: "In all things that are social we can be as separate as the fingers, yet one as the hand in all things essential for mutual purposes."[12]

One might say that we are as separate as the fingers, yet one as the hand in all things essential for mutual progress. It is the combination of localism, ethnic variety, and individualism that helps to maintain freedom in America. Booker T. Washington understood this. Unfortunately, many other reformers have not.

JEROME SAINTJONES



The Booker T. Washington Monument at Tuskegee University. The inscription reads: "He lifted the veil of ignorance from his people and pointed the way to progress through education and industry."

Washington came under attack from other black leaders, for his speech seemed patronizing. Actually, he had caught the true spirit of capitalism: service to one's fellowman. In the free market, he who serves the best generally will be successful.

In spite of his controversial Atlanta speech, Washington's fame continued to grow. Honors came from near and far. Theodore Roosevelt sought his advice, as did President Charles W. Eliot of Harvard, who presented him with the first degree awarded by that university to a Negro.

Washington's constant traveling and speaking added to an already overburdened schedule. His wife and associates begged him to slow down. His reply: "No—there is so much to do, and time is so short." It was even shorter than he thought. In November 1915, Booker T. Washington died of a heart attack at the age of 59. At his death, Tuskegee had over 60 buildings and an endowment of nearly three million dollars. Both the school and the man were internationally famous.

Unfortunately, much of the foundation Booker T. Washington laid was to be undone by government intervention. Minimum wage laws have made it more difficult for blacks to find jobs.[13] Welfare programs have mitigated against the most important economic unit in society—the family. And affirmative action programs have often served to increase white animosity toward blacks.[14]

Despite these setbacks, the example of Booker T. Washington still remains. His achievements show that it is possible for someone–no matter what his race—to come "up from slavery" and become a truly free man. As Washington put it: "Each one should remember there is a chance for him, and the more difficulties he has to overcome, the greater can be his success."[15] May he still inspire us today. □

1. Booker T. Washington, *Up From Slavery* (New York: Airmont Edition, 1967), pp. 15-16.
2. *Ibid.*, p. 26.
3. *Ibid.*, p. 43.
4. *Ibid.*, p. 44
5. *Ibid.*, p. 99
6. Benjamin Quarles, *The Negro in the Making of America* (New York: Macmillan Pub. Co., 1964, 1969), p. 166.
7. Washington, quoted in Quarles, p. 167.
8. Mary Church Terrell, quoted in Quarles, pp. 166-167.
9. Washington, quoted in Michael R. Lowman, et. al., *Heritage of Freedom* (Pensacola, Fla.: Beka Book Publications, 1982), p. 317.
10. *Ibid.*, p. 318.
11. Quarles, p. 171.
12. Washington, quoted in Russell L. Adams, *Great Negroes: Past and Present* (Chicago: Afro-Am Publishing Co., 1984), p. 137.
13. Walter E. Williams, *Youth and Minority Unemployment* (Stanford, Calif.: Hoover Institution Press, 1977), p. 14.
14. Thomas Sowell, *Ethnic America* (New York: Basic Books, Inc., Pub., 1981), p. 223.
15. O. K. Armstrong, "Apostle of Goodwill," in *Great Lives, Great Deeds* (Pleasantville, New York: The Reader's Digest Association, 1964), p. 291.

Helping the Poor

by Jane S. Shaw

Many of us are old enough to remember when, back in the 1960s, author Michael Harrington introduced the nation to the "invisible poor." After reading his book *The Other America,* we realized that poor people were all around us. We just hadn't noticed them.

One of the accomplishments of the 1960s war on poverty and the continued growth of government welfare programs is that now we do notice the poor. It's nearly impossible to go through a major city without seeing a person who is or appears to be homeless. While controversy surrounds the actual number, clearly there are more homeless than there used to be. As of 1985, 14 per cent of the U.S. population had incomes below the poverty level; the percentage was 12.1 in 1969. Our government funds, it seems, have bought more poverty.

But government programs are only part of the problem. Being homeless and hungry has become something admirable. Each year, as winter approaches, and especially around the holidays, television and newspaper reporters seek out and interview the homeless. Advocates for the homeless such as Mitch Snyder in Washington, D.C., begin campaigns to attract money and shelter.

The abject poor become objects not only of sympathy but even of respect. They are portrayed as having a "special significance," as Peter Marin wrote in *Harper's,* January 1987. He said that the homeless "are all we have left to remind us of the narrowness of the received truths we take for granted." Some months ago, celebrities and politicians slept overnight on grates in the streets of Washington to publicize the plight of the homeless and win support for a new Federal program. In effect, they lauded the homeless as stoic heroes who survive society's neglect night after night.

This adulation is a cruel distortion. While certainly some of the "grate people" have overcome tremendous difficulties, by and large they have not overcome! At this point in their lives, they are losers.

Some are former mental patients who may never be self-sufficient. Others are not so different from the rest of us. But they have made serious mistakes that must be corrected if they are ever to lead normal lives. They have left school, run away from home, or quit jobs—and ended up on the streets. They desperately need incentives to rebuild their lives. Unfortunately, we are taking away their incentives.

To let sympathy turn to acceptance of their state puts a stamp of approval on their self-destructive behavior.

There is a better way. Three years ago, I left New York City for a small town in southwestern Montana. Suddenly, I was back in the 1960s with Michael Harrington where the poor are almost invisible.

Montana is a low-income state. Its mining industry is dying; its agriculture is usually marginal; growth industries are almost nonexistent. Attracted by the scenic beauty, people come to Bozeman and then try to figure out how to make a living. Many have a difficult time.

The minimum wage —or less—is often the market wage. Young people with master's degrees in architecture and journalism wait on tables or clean motel rooms. Literally hundreds of people apply for each teaching job.

But poor people are not obvious the way they are in New York and Washington. Just about everyone has *some* place to live. If it is a

Jane S. Shaw, a senior associate of the Political Economy Research Center in Bozeman, Mont., has helped provide free breakfasts and shelter at St. Bartholomew's Church in New York City.

This article originally appeared in The Christian Science Monitor.

PAT WATSON

Jane McCommack checks pantry supplies at Chapel Rock Christian Church. Food is donated by members.

trailer, well, many Montanans live in trailers. The same applies to old houses where the plumbing is poor. And when poor people shop at the Salvation Army Thrift Store, they mingle with their more affluent neighbors rummaging for a bargain.

For those who truly need help, we have an abundance of charity, just as big cities do. Churches supply food, a help center provides counseling, and a senior citizens' center serves older people. Big Brothers and Big Sisters help troubled children. We have the Salvation Army.

But there is a difference. Unlike charity in big cities, help is given quietly and anonymously. Those who donate at church and elsewhere don't know who receives their donations.

I contend that all are better off as a result.

Writing in the nineteenth century after visiting Britain, the great social observer Alexis de Tocqueville became disillusioned with what he called "public charity" or welfare. To obtain public charity, people's names were inscribed on the parish welfare rolls. These inscriptions, he said, were "a notarized manifestation of misery, of weakness, of misconduct." The people on the rolls were permanently marked as paupers; their debasement was public, and they lost the will to better their condition.

Instead, he argued, charity should be given "secretly and temporarily." He believed that people who quietly received temporary help would retain an incentive to move into (or back into) the mainstream of society. That, I believe, is what happens in Bozeman.

Michael Harrington, the designers of the English poor laws, and many of us in 20th-century America seem to have forgotten that poverty can be a transient condition. Today's poor need not be poor tomorrow. The tragedy is not so much that the poor exist but that, in our big cities, they come to a halt on the bread line. □

A REVIEWER'S NOTEBOOK

All It Takes Is Guts

by John Chamberlain

Walter Williams, who teaches at Virginia's George Mason University and writes a syndicated newspaper column on the side, is usually referred to as a black economist. I would prefer it if he were called a good economist who happens to be black. He is "free market" to his bone marrow, a devotee of Hayek and Mises, and he doesn't miss a bet in scoring points against interventionism wherever it rears its ugly head.

Naturally, since he is black, his attention is frequently directed to the consideration of how bad economics hurts his fellow blacks. His *All It Takes Is Guts: A Minority View* (Regnery Gateway, 1130 17th Street, NW, Washington, DC 20036, 189 pp., $16.95 hardback), a collection of his sharp newspaper columns, returns again and again to such topics as quotas, comparable worth laws, and the minimum wage. These are things that lower standards of living for everybody, save for a favored few, but they work particular hardship on blacks as the most vulnerable individuals in society.

Williams objects to quotas in hiring because, as it seems to him, their use comes within the scope of a bill of attainder. They fix blame for past wrongs to blacks on people who had nothing to do with the original injustices. In a column titled "Quotas are Unconstitutional" Williams takes, for an example, "the white kid who's denied admission to a particular college in order to meet quota requirements for a black kid." "How," he asks, "is that white youth accountable for slavery and past oppression of blacks?" The wrong done to the white kid is obvious. But the black kid who is favored is hurt, too. He will be suspected of getting a diploma without really qualifying for it.

To universalize his approach to the harm done by quotas, Williams applies his arguments to women and to minorities in general. He is particularly scathing about judges who use busing to establish arbitrary racial mixes in schools.

The minimum wage has been a prime preoccupation with Williams for ten years. He objects to it on logical grounds: no sensible company is going to hire people for long whose contribution is not worth their keep. The logic of the Williams approach is amply buttressed by statistics. Anybody who is unskilled can have a hard time if minimum wages are set too high, but black teenagers who have had poor schooling are particularly vulnerable.

"Economists," says Williams of the minimum wage, ". . . differ on how much unemployment is caused by it." But they agree on the fact that black teenage unemployment has been increasing for a decade. It is now around fifty per cent, more than double that of white teens.

The big unions, says Williams, like minimum wage laws for selfish reasons. The laws keep the unskilled out of the labor markets. But

the unions here are shortsighted. Mechanization is the obvious answer of the employer who can't afford the luxury of hiring high-wage union labor. Williams devotes several good columns to the question of comparable worth. He is particularly amused by the feminists' efforts to equate secretarial skills and truck driving. Point systems may be devised to equalize them, but the market will rule in the end simply because those fitted to drive trucks are less numerous than potential stenographers.

Protectionism is another topic that gets caustic attention in typical Williams columns. The plight of specific steel workers arouses his compassion, but costs, he says, are costs. The benefit side of steel protection is that profits will momentarily rise as a tariff goes into effect. But Williams points to the cost side. "Manufacturers of steel-using products," he says, "face higher input prices. One effect is to raise the price of such goods as autos, washing machines and filing cabinets. If these goods cost more, consumers buy fewer of them. That results in reduced employment in those industries. So the tariff on foreign steel shifts unemployment from the steel industry to some other industry."

Williams has made several trips to South Africa. He was disgusted with apartheid, but he has never seen the sense of applying sanctions to South African industry. Where sanctions are effective, they only succeed in putting blacks out of work. Williams horrified many of his listeners in South Africa when he said the two sides in the fight over apartheid deserve each other. They are both stupidly socialist in Williams' opinion.

On South Africa's government-owned television Williams pointed out that the leadership of the country "is ignorant of the economic definition of socialism, which is government ownership and/or control over the means of production. In South Africa, the government owns coal-to-oil conversion plants, railroads, the telephone company, and other major industries. Through licensing and regulation it controls all enterprises from banks, gold mines, and insurance companies to supermarkets. It even tells its citizens when they may buy toilet tissue, soap, and dog food."

Williams found that white businessmen in South Africa would love to hire more blacks, but the law thwarts them "in the name of maintaining 'labor peace.' Racist labor unions and other vested interests use government to get laws written which bar blacks from competing. Blacks are not allowed to open businesses in white areas. But . . . whites are not allowed to open businesses in black areas either."

Black South Africans follow Archbishop Tutu in speaking out against capitalism and for socialism. At the same time they answered "yes" to such questions as "Do you think you should be able to purchase property where you want?" Williams decided that blacks in South Africa were really for capitalism without knowing it.

"The most constructive step the South African government can make," says Williams, "is to own up to the fact that it is a socialistic regime. In fact, socialism is the number one enemy of the entire continent of Africa." The history of sub-Saharan Africa seems a particular scandal to Williams. "Uganda," he says, "won independence in 1962. But black rule didn't bring freedom and prosperity. Instead, under Idi Amin, more than 50,000 blacks were murdered. . . . The same story of oppression and murder repeats itself whether it is in the newly formed government of Zimbabwe, Zaire, the Central African Republic, Mozambique, or the never-colonized Ethiopia."

Americans must condemn South African apartheid, says Williams, but "the solutions to Africa's problems go far beyond the mere installation of a black government to replace a white one." The Zulu chief Gatsha Buthelezi may have the answer. He would apply the thinking of James Madison to the South African situation, with tribal rights substituted for states' rights, and with a Bill of Rights protecting the individual of whatever color. □

THE FORDS: AN AMERICAN EPIC
by Peter Collier and David Horowitz
Summit Books, 1230 Avenue of the Americas, New York, NY 10020.• 1987 • 496 pages • $22.95

Reviewed by Russell Shannon

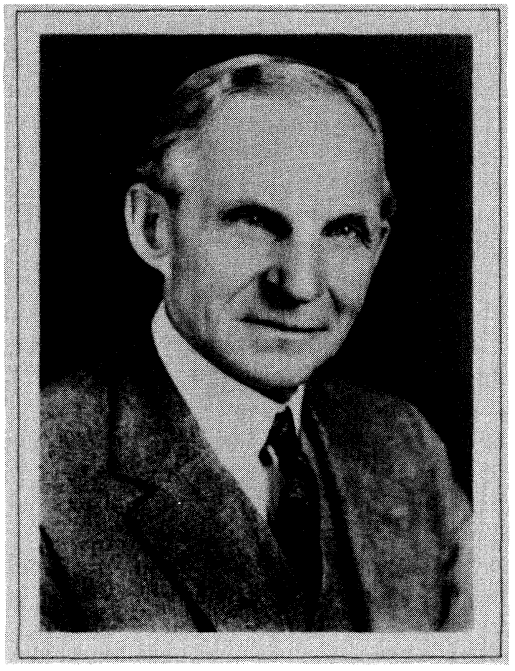
Perhaps a more fitting subtitle for Peter Collier and David Horowitz's new account of the Ford family would be the title Winston Churchill chose for the final volume of his World War II memoirs: *Triumph and Tragedy*. Surely, Henry Ford's mass production of the Model T ranks as one of the supreme triumphs of American entrepreneurial history. Yet the subsequent development of both Ford's industrial domain and his descendants' lives is riddled with tragedy.

The first Henry Ford, whose father had emigrated from Ireland to America during the potato famine of the 1840s, was far more than simply one of the first builders of an automobile. He was also the epitome of the innovator, determined to make a commercial success of a car whose selling price lay within the grasp of ordinary Americans.

To this end, Ford's assembly line production was clearly the key. Although Collier and Horowitz do not indicate that Ford ever read Adam Smith (in fact, the flaws in his knowledge of history were appalling!), a statement Ford made in 1903 reads like the sequel to the first few pages of *The Wealth of Nations*: "The way to make automobiles," Ford said, "is to . . . make them all alike . . . , just as one pin is like another when it comes from a pin factory."

Much as Adam Smith's famous pin makers benefited from the division of labor, Ford's auto workers vastly improved their productivity when the first assembly line was established at the Highland Park plant in 1913: from the 12½ hours previously required to assemble a Model T, the time dropped drastically to 1½ hours.

Ford cut prices on his cars, but costs were so low and consumer demand was so elastic that profits soared. At the insistence of his assistant, James Couzens, Ford then agreed to raise his workers' pay to $5 a day, making it easier for them to afford a Ford. But the company reaped further benefits, for the increased pay reduced labor turnover and lowered production costs. What splendid testimony to the validity of Adam Smith's argument that the pursuit of self-interest and social benefit can go hand in hand.



Henry Ford, 1863–1947:
"The way to make automobiles is to make them all alike. . ."

Sadly, however, as he grew older, Ford engaged in increasingly bizarre and brazen behavior. When some workers violated his demands for staunch loyalty by purchasing General Motors cars, they were fired. When other workers flirted with the fledgling United Auto Workers, Ford sped up the assembly line in reprisal—"causing a syndrome involving exhaustion and despair which eventually became known in Detroit medical circles as 'Ford-itis.' "

Henry's only son, Edsel, who had become largely responsible for much of the company's operations, advocated accommodation with the labor union, but his arguments fell on deaf ears. As a result, much bloody strife ensued. Edsel was also one of those who repeatedly urged his father to confront the growing rivalry of Chevrolet by introducing more new models. But Henry constantly balked, allowing his

company's market share to fall dramatically and depriving consumers of fresh options.

Collier and Horowitz suggest that Ford's life had Shakespearean overtones. Certainly, there are parallels with the bard's tragic heroes, for Henry often seemed to be playing King Lear to his son's Cordelia, ignoring Edsel's wise counsel while others at the Ford factories pandered to his idiosyncracies.

Overcome by denial and frustration, Edsel succumbed to cancer at a premature age. Henry's grandchildren suffered from alchoholism and other problems. The burden of their inheritance proved too great, calling to mind the remark Andrew Carnegie made in his "Gospel of Wealth" back in 1889 that "great sums bequeathed often work more for the injury than for the good of the recipients."

Yet despite the fiasco of the Edsel model, grandson Henry Ford II finally was able to set the company firmly on its feet by emulating managerial practices of its arch-rival General Motors. An internal system of checks and balances limited the scope for individual power and abuse. Henry II also removed the Ford family from automatic control of the company and turned it over to professionals.

In fact, the image of the phoenix is appropriate for the recent success of the firm. *Fortune* magazine reported in its issue for January 4, 1988, that "Ford has captured U.S. leadership in styling and reputation for quality. Last year Ford passed the General in profits for the first time since 1924 . . . ."

What has all this to say about free markets? Would a system of stricter and more pervasive government control have prevented some of the problems and abuses? Perhaps, but clearly that proposal poses an even more awesome threat.

At least in a free market system, consumers and workers have a greater range of choice. Surely, it was partly the *competition* of automotive rivals which prompted changes in Ford's management system and design quality.

In the end, what really causes the reader to shudder is the thought: what would have happened if a man like Henry Ford I had become our *king*? Had that been the case, then not just one automotive empire but our whole nation could have been bound by tragedy. □

(Professor Shannon teaches in the Economics Department at Clemson University.)

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THE FREEMAN
IDEAS ON LIBERTY

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Thomas C. Stevens, chairman; Ridgway K. Foley, Jr., vice-chairman; Paul L. Poirot, secretary; H.F. Langenberg, treasurer.

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Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

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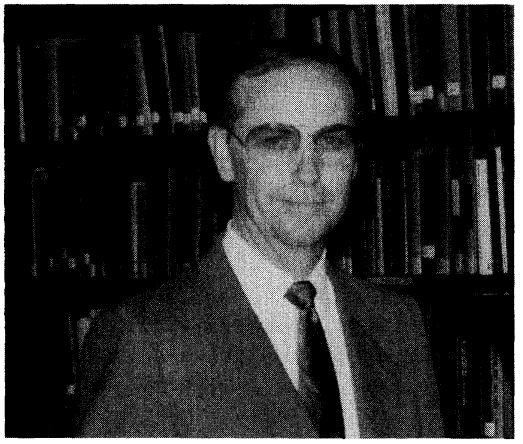
PERSPECTIVE



Bruce M. Evans

The Power of Principle

Consistency of thought and behavior is indeed rare. The vagaries of life often are characterized by a continual shifting of principles and practices "to meet the demands of our modern world." There is today, perhaps as always, a dearth of exemplars of principled life—role models of internal and social consistency and integrity.

The 90th anniversary of Leonard Read's birth reminds us of a lifetime devoted to the practice and promotion of principled freedom. Through The Foundation for Economic Education, Mr. Read devoted almost 40 years to describing and calling for an ideal. He took the time and exerted the effort to analyze daily activities—personal, social, and political—in the context of principles and moral philosophy.

It seems somewhat ludicrous that we readily accept group action which would be considered unconscionable if initiated by individuals. Yet, the political agenda is generally shaped by special interest focus on outcomes with little thought for the violation and destructive abandonment of principles. Rarely do we ask, "Is this morally right?" in a discussion of proposed legislation. Our preoccupation is rather with good intention and popular appeal. Thus, unprincipled behavior often becomes the law of the land through action without thought and the anonymity of group process. In the absence of principle, power rules.

FEE continues to carry the banner for principled lives, public and private. The example and

heritage provided by Leonard Read require our thoughtful perseverance in a cause served best by responsible, principled individuals.

—BRUCE M. EVANS
President

"I, Pencil" Gets Around

In December 1958, FEE's founder and long-time president, Leonard E. Read, wrote a short piece about an ordinary wooden lead pencil. He wrote in the first person, as if the pencil itself were writing. "I, Pencil," he wrote, "am a complex combination of miracles: a tree, zinc, copper, graphite, and so on. But," the pencil continued, "to these miracles which manifest themselves in Nature an even more extraordinary miracle has been added"—the "miracle" of uninhibited creative energy, bringing together millions of tiny know-hows of countless individuals. No human being could mastermind the complexities of making a pencil, Read wrote, any more than he could put molecules together to create the tree which is cut into small slats from which pencils are formed.

Read's explanation of the complicated division of labor and international cooperation required to produce something as simple as a pencil has struck a responsive chord with many people all over the world. "I, Pencil" has been reprinted in anthologies for school children, translated into foreign languages, and parodied in an ad several years ago in *Review of the News*. A diagram of a pencil was used by Hillsdale College, with quotes from the article, to illustrate why the free market is essential. Milton Friedman mentioned "I, Pencil" in his 1980 TV series, *Free to Choose,* and in his book of the same name. Thomas Sowell referred to it in his profound and thoughtful *Knowledge and Decisions,* when he wrote, "It has been said that no one knows how to make even a simple lead pencil."

"I, Pencil" has even been used in a recent best-selling Japanese comic book, *Japan Inc., Introduction to Japanese Economics,* which has been translated into English and is now available in this country. Several panels describe the ingredients, the tools, and the international cooperation needed to make a pencil. Then the legend reads, "It's not that each person works for the sake of making pencils. All of them work for the goods they want. . . . we make the goods they want so they'll make the pencils we want. . . . It's not that someone somewhere gives an order. Pencils are made right before our eyes, but it seems like a miracle."

—BBG

The Loss of Freedom

Much of the loss of freedom with the growth of big government has been concealed because the direct losses have been suffered by intermediary decision-makers—notably businessmen—and it is only after the process has gone on for a long time that it becomes blatantly obvious to the public that an employer's loss of freedom in choosing whom to hire is the worker's loss of freedom in getting a job on his merits, that a university's loss of freedom in selecting faculty or students is their children's loss of freedom in seeking admission or in seeking the best minds to be taught by.

—THOMAS SOWELL
Knowledge and Decisions

While They Starve

The Government of Ethiopia has so severely restricted emergency relief operations in the country's north, a region ravaged by both drought and war, that as many as two million people are out of reach of any known system of food distribution, aid officials and Western diplomats say.

Because of the restrictions, these officials say, hundreds of thousands of tons of donated food are piling up at ports and may never reach those in need. Agricultural seeds, too, are not being distributed. This means that farmers who must soon plant crops cannot do so, which could lead to even greater problems next year.

—*The New York Times,*
April 29, 1988

THE FREEMAN
IDEAS ON LIBERTY

Penalty of Surrender

by Leonard E. Read

Editors' Note:

Leonard E. Read founded The Foundation for Economic Education in 1946 and served as its President until his death in 1983. He was a philosopher, teacher, and exemplar.

It is difficult to measure the full influence of Leonard Read. He wrote more than two dozen books and hundreds of articles, delivered over a thousand lectures, and changed more lives than any of us ever will realize. In trying to assess his personal impact, perhaps it is best to say that Leonard Read taught us what is important. Principles are important. Moral philosophy is important. And, as he showed by the example of his own life, courage and an abiding faith in one's convictions are important.

On this, the 90th anniversary of Leonard Read's birth (September 26, 1898), we are pleased to publish this article which first appeared in the April 1957 issue of The Freeman.

A certain business leader, perhaps among the most publicized during the last two decades, once severely lectured me on my unswerving and uncompromising behavior. He charged that I saw things only in blacks and whites. He argued that practical life was lived in shades of grays, actually in the shadows of these two extremes. He suggested that I had a nice chance of "going far" in the world, if only I would become more pliable to the thoughts and actions of my fellows. He really wanted me to be more agreeable to his middle-of-the-road political theories.

The compromising attitude is exalted by many and deplored by only a few. Most current discussions are tempered with concepts of compromise and expediency.

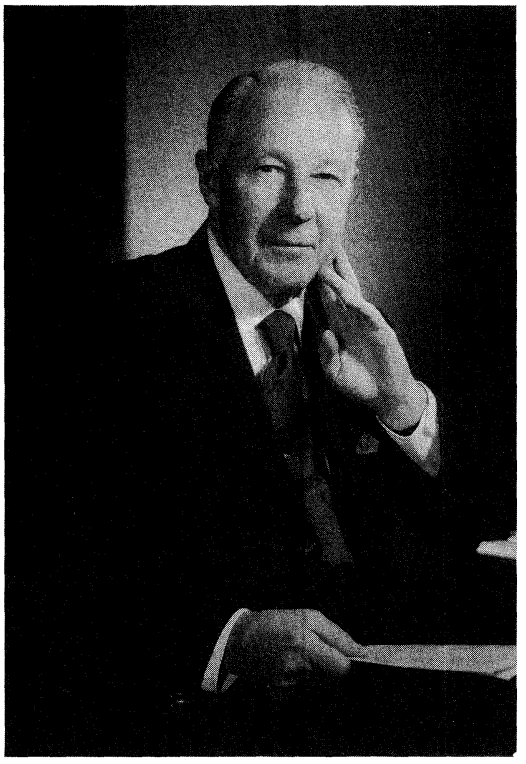
Compromise, like many other words, has different meanings for different persons. I want to use the term in the sense of one of the definitions given by Webster: "The result or embodiment of concession or adjustment." I wish to show that compromise is potentially good when applied in a physical sense and that it has no application whatever in a moral sense.

For example, you and your wife are spending what is hoped will be a happy evening at home. She chooses to watch TV and you elect to explore Toynbee's *Study of History*. The scene appears peaceful as you sit side by side. But to you the TV is making a lot of distracting noise.

Here are all the possibilities for turning a cheerful evening into one of disharmony. But compromise can come to your aid. Your wife can decrease the noise of the TV to the point where she can still hear it, and you can move to some remote corner where you can comprehend Toynbee just as well as anywhere else. Harmony can thus be preserved by compromise.

Compromise in this sense is an adjustment of physical situations. It is the process by which conflicts are reduced to the point most satisfactory to all parties concerned. When thought of in this way, compromise is the great harmonizer, the attitude that makes living together—social life—a pleasure.

Indeed, the market place of willing exchange where tens of millions of transactions go on



Leonard Read was born on a farm in Michigan. He claimed that his training in economics began at the tender age of eight. "My father started me milking cows while I was still a small boy. I learned the relationship between hard work and a quart of milk. All else in economics is but embellishment of this primary lesson."

At 19, Read's formal education was interrupted by his entry into World War I as an airplane mechanic with the American Expeditionary Forces. After the war, he sold insurance, worked as a cashier, then opened his own produce business. In 1927, he began a career in Chamber of Commerce work as secretary of one of the country's smallest Chambers. He was later manager of the Western Division of the Chamber of Commerce of the United States for 10 years. In 1939, he became general manager of the world's largest Chamber in Los Angeles. His work there won him the executive vice-presidency of the National Industrial Conference Board. He left the NICB in 1946 to organize FEE.

daily is one vast area of compromise. Buyers aim at low prices. Sellers aim at high prices. In a free market, unhampered by private thieves and political restrictions, there is an adjustment of these diverse desires. Compromise establishes the price at which the mutual satisfaction of buyer and seller is at its highest level.

It is in the physical realm that most of our daily life is lived. In this realm compromise is good and it is practical. It begets harmony and peace.

How easy it would seem then, finding compromise so useful in such a vast segment of life, to conclude thoughtlessly that it has an equal place, a comparable value, in that phase of life which consciously occupies little of our thoughts: moral life.

Principles Defy Compromise

But this is precisely the point where I believe many of us are the victims of a confusion of terms. What is compromise in physical affairs —that is, in an adjustment of physical positions—is something entirely different when applied to principles and morality.

For example, let us make the reckless assumption that most of us are committed to the Biblical injunction, "Thou shalt not steal." This is based on the moral principle that each person has the right to the fruits of his own labor. The point I wish to make—my major point—is that this *as a principle* defies compromise. You either take someone else's property without his consent, or you do not. If you steal just a bit—a penny—you do not compromise the principle; you abandon it. You surrender your principle.

By taking only *a little* of someone's property without his consent, as distinguished from taking a lot, you do compromise in the physical sense the amount you steal. But the moral principle, whatever the amount of the theft, is surrendered and utterly abandoned.

If all the rest of mankind is in favor of passing a law that would take the property, honestly acquired, of only one person against his will, even though the purpose be allegedly for the so-called social good, I cannot adjust myself both to the moral injunction, "Thou shalt not steal," and to the demand of the millions. Principle does not lend itself to bending

or to compromising. It stands impregnable. I must either abide by it, or in all fairness, I must on this point regard myself as an inconsistent, unprincipled person rather than a rational, reasonable, logical one.

What Are Moral Principles?

The question immediately arises as to what constitutes principle. Here again is a term with varying meanings to different persons. I must, therefore, define what I mean.

The Ten Commandments are admonitions derived from the religious experience of an ancient people. In terms of their origin, the Commandments are cast in the form of intercepts of the will of God; in terms of their application, they are imperatives admitting of no dilution. They were expressions of principles at least to the ones who received them, and have been adopted as such by countless millions. Their acceptance springs from the studied deductions of the wiser among us, confirmed through centuries of observation and experience.

The correctness of a principle has little to do with the intensity of conviction with which a man holds it. Someone else may hold a contrary principle with like intensity. No man can get nearer to the truth than his own highest apprehension of it. Ultimate insights may differ, and such differences will always be part of the human scene. But there is another type of difference which is more pertinent to the point of this essay: the difference between those who accept unyieldingly a moral principle as their standard, and those who accept a principle watered down by "practical" considerations. Lord Morley warned of this danger when he deplored the tendency to forget the principle itself in our preoccupation with the practical difficulties of applying it.

To me "Thou shalt not steal" is a principled injunction not alone because some sage of antiquity said so, but largely because my own experience has compelled me to adopt this as a principle of right conduct which must be adhered to if I am not to destroy my own integrity, and if I am to live peacefully with my fellow men.

To those of opposite judgments, who believe that they should gratify their personal charitable instincts not with their own goods, but with goods extorted from others by the police force, who fail to see how thieving damages integrity, and who accept the practice of political plunder as right and honorable—to them, "Thou shalt not steal" must appear wrong in principle.

Sound Judgment Required

Whether a principle is right or wrong cannot in any ultimate or absolute sense be determined by any single one of us human beings. Principles on the level of human perception are what are judged to be the rules of life or nature; what are judged to be universal, eternal verities; what are judged to be fundamental points of reference. But, human judgment is fallible. Therefore, whether a stated principle is held to be right or wrong will depend on the quality of the individual's judgment. Aristotle claimed that there were a million ways to be wrong; only one way to be right. How easy for fallible beings to decide on a wrong way!

Sound judgment leads toward right principles. No person can rise above his best judgment, and he can rise only as fast as his judgment improves. On what, then, is an improving judgment dependent? My answer is: on revelation—"The disclosing or discovering . . . of what was before unknown . . ." Other terms for revelation are insight, cognition, inspiration, extrasensory perception. On what does revelation or insight rest? Surely, on conscious effort, education, the kind of persons with whom one associates, the topics selected for discussion, what one chooses to read—all of these relate to one's perception. More fundamental, however, than anything else is intellectual integrity, without which, I am certain, the cognitive stream cannot flow at its best. Goethe expressed the idea thus: "Nature understands no jesting; she is always true, always serious, always severe; she is always right, and the errors and faults are always those of man. The man incapable of appreciating her, she despises; and only to the apt, the pure, and the true, does she resign herself, and reveal her secrets."

Intellectual integrity simply means to reflect in word and in deed, always and accurately, that which one believes to be right. Integrity

cannot be compromised. It is either practiced or not practiced.

Certainly, there is nothing new about the efficacy of accurately reflecting what one believes to be right. This principle of conduct has been known throughout recorded history. Now and then it has been expressed beautifully and simply. Shakespeare enunciated the principle when he had Polonius say:

> This above all: to thine own self be true,
> And it must follow, as the night the day,
> Thou canst not then be false to any man.

Edmond Rostand had the same principle in mind when he wrote for Cyrano:

> Never to make a line I have not heard in my own heart.

The Bible announces the penalty of surrender —what it means to abandon the truth as one sees it:

> The wages of sin is death.

Whether the wages of sin be mere physical death, as when men shoot each other over ideological differences, or profound spiritual death, as in the extinction of integrity, character, and self-respect, one needs to make but casual inquiry to verify the rightness of this Biblical pronouncement. Abundant testimony is being provided in our time. Nor is the end in sight.

Principles Surrendered

All the world is filled with examples of surrendered principles: men who know practically nothing about themselves trying to play God, attempting to control and forcibly direct the creative actions of others; the glamour of popularity and shallow earthly fame rather than the concepts of rightness directing the policies of nations; expediency substituting for the dictates of conscience; businessmen employing "experts" to help them *seem* right, often at the expense of rightness itself; labor leaders justifying any action that gratifies their lust for power; political leaders operating on the premise that the end justifies the means; clergymen preaching expropriation of property without consent in the name of the "common good"; teachers not explaining but advocating coercive collectivism; aspirants to public office building platforms from public opinion polls; farmers, miners, and other plunderbundists uniting with the police force to siphon unto themselves the fruits of others' labor; arrogance replacing humility; in short, surrender of principle appears to be the distinguishing mark of our time.

If we were suddenly to find foreign vandals invading our shores, vandals that would kill our children, rape our women, and pilfer our industry, every last man of us would rise in arms.

Yet, these ideas born of surrendered principles are the most dangerous vandals known to man. Is the Bible right that the wages of sin is death? Observe the growth of domestic violence. Note the extent to which the organized police force—government—promotes and enacts plunder rather than inhibits it. Scan the last 40 years of war, hot and cold; wars to end wars, each serving only as a prelude to larger wars. And, today, we worldlings, in angry and hateful moods, stand tense and poised to strike out at each other, not with shillelaghs, pistols, hand grenades, and cannons, but with mass exterminators of the germ and atom types, types that only a people of surrendered principles could concoct.

A Final Question: Is Honesty Dangerous?

Perhaps it is timidity that prevents many a man from standing squarely on his own philosophy and uttering nothing less than the highest truth he perceives. He fears the loss of friends or position. Actually, the danger lies in the other direction, in settling for less than one's best judgment.

Does it take courage to be honest? Does one have to be brave to express the truth as he sees it? Indeed, *it is not dangerous to be honest,* but rather a mark of intelligence. Being honest and adhering to principle requires intelligence more than courage. Courage without intelligence makes men blusterous and cantankerous with their views; they offend with their honesty. But, the villainy in that case is their cantankerousness, not their integrity.

Finally, some may contend that even if everyone were a model of intellectual integrity, by reason of the great variety of judgments,

differences would still remain. This is true. But differences lead in the direction of truth in an atmosphere of honesty. Honest differences are livable differences.

Life in a physical sense is a compromise, a fact that need not concern us. But, when vast numbers of people surrender living by what they believe to be right, it follows that they must then live by what they believe to be wrong. No more destructive tendency can be imagined.

Honesty—each person true to his highest conscience—is the condition from which revelation springs; from which knowledge expands; from which intelligence grows; from which judgments improve. It is a never-ending, eternally challenging—a thoroughly joyous—process. Indeed, it *is* living in its higher sense. □

Leonard Read Changed My Life

by Jacob G. Hornberger

From the time I was a small child, I had planned to become an attorney. I never had any doubt that I would spend my entire life practicing law. Upon graduation from law school in 1975, I returned to my hometown to begin my long-awaited legal career.

Two years later I discovered *Essays on Liberty,* a series of books which The Foundation for Economic Education had published in the 1950s. It was there that I discovered the thoughts and ideas of Leonard E. Read, who had founded The Foundation in 1946. While I immediately recognized the tremendous significance of his message, it was not until years later that I realized that Leonard Read had changed my life forever.

When I was growing up, I learned certain important principles about the lives and property of other people. It was morally right to care for others, especially those in need. It was morally wrong to steal, no matter how well-intentioned. If I desired to assist others, I had to do so with my own efforts and resources, rather than with what I could take from others.

Soon after I began my legal career, I accepted a position on the Board of Directors of our local Legal Aid Society, a government agency whose purpose was to provide legal services to the poor. It seemed an excellent opportunity to use my legal background to assist people in need. Until I discovered the philosophy of Leonard Read, it never occurred to me that my attempt to help others in this way was fundamentally flawed.

Stealing cannot be made morally legitimate by legalizing it into a political system. If it is wrong for individuals to take the property of others, even to satisfy the urgent needs of the poor and disadvantaged, it is equally wrong to accomplish this through political representatives. Law is perverted when, instead of protecting property and choice, it is used to plunder property and manipulate choice. No matter how urgent the needs of others, the coercive redistribution of wealth is still morally

Mr. Hornberger is Director of Programs at The Foundation for Economic Education.

wrong. The Legal Aid Society was providing legal assistance to the needy with resources that had been forcibly taken from others through the political process. Realizing that I was participating in this wrongful conduct, I resigned my position with Legal Aid.

After discovering Read's freedom philosophy, I could not understand why other people did not recognize the immorality of using the political system to take from some to give to others. As Read so aptly observed, no matter how honest and honorable people may be in their personal and business affairs, for some reason they are incapable of recognizing the immorality of a political system founded on plunder and control. The resulting tragedy is that while most persons live principled lives in their everyday activities, they live lives without principle with respect to their ideological beliefs.

What then can a person do most effectively to advance the cause of liberty? Since an individual is given only one life to reform and refine, each person should expend his efforts striving to improve himself rather than trying to change everyone else. To freedom devotees, this method of self-improvement means becoming so proficient at explaining the freedom philosophy that others who seek truth will become attracted to the devotee's ever-growing light of wisdom and understanding.

This process of self-improvement includes the personal maintenance of philosophical and practical purity with respect to the proper role of government. Leonard Read continually emphasized that principles can never be compromised; they can only be abandoned. Therefore, to maintain an ideal concept of government to which others will be attracted, it is imperative that each of us never advocate, or participate in, any political violation of liberty. This strict adherence to principle was summed up in Read's maxim, "No leaks!"

I did find one aspect of Read's writings very disconcerting. Underlying his entire philosophy was a belief in God. I simply could not understand how such an intelligent person, who had such brilliant insights into political theory, could actually believe such nonsense. Becoming quite exasperated with Read's conviction on this matter, I finally decided to investigate. It was not long after I began reading the Gospels that I discovered that Read was right about this aspect of life as well.

Leonard Read was a pioneer. While others were expressing the economic benefits of an unhampered market economy, Read was quietly presenting the moral case for freedom. It was this uncompromising, moral defense of liberty which ultimately changed the course of my life. □

Books by Leonard E. Read

Leonard Read wrote books on a wide range of social, economic, political, and moral issues—but always deeply concerned with the methods of freedom. Still in print—and available from FEE—are 18 of his books. Write to us for prices.

Accent on the Right
Anything That's Peaceful
Castles in the Air
The Coming Aristocracy
Deeper Than You Think
The Freedom Freeway
Having My Way
How Do We Know?
Let Freedom Reign
Liberty: Legacy of Truth
The Love of Liberty
The Path of Duty
Seeds of Progress
Talking to Myself
Then Truth Will Out
To Free or Freeze
Vision
Who's Listening?

On the Foundations of Economic Liberty

by Roger Pilon

I. INTRODUCTION: TWO KINDS OF LIBERTY?

As the celebration of the bicentennial of our Constitution continues, we are coming increasingly to appreciate the connection between our economic liberties and our judiciary. It is a commonplace, of course, that enterprise has come under increasing restraint and regulation over the course of this century. In a review of yet another proposal to Federally charter the corporation, for example, L. E. Birdzell, Jr., writing in the bicentennial year of our independence, pointed to some 40 to 50 significant Federal statutes that "may reasonably be viewed as imposing requirements on corporate management in favor of employee, consumer, investor or environmental interests, ranging all the way to comprehensive regulation of entry, prices and services in much of the transportation, communication, energy, and banking industries."[1] The dozen years that have passed since that bicentennial have witnessed no appreciable measure of relief. On the contrary, in many areas the burdens upon enterprise have only increased, so much so that President Reagan, speaking from the Jefferson Memorial on the eve of last year's celebration of our founding, thought it fitting to call for an Economic Bill of Rights, which he later characterized as a "fundamental reform that sees to it that our economic freedom is every bit as protected as our political freedom."[2]

Roger Pilon is the Director of the Asylum Policy and Review Unit of the Department of Justice. This essay is a slightly revised version of a speech Dr. Pilon delivered at the American Bar Association's Annual Meeting in San Francisco, California, on August 9, 1987, ABA Section of Corporation, Banking and Business Law Showcase Program: "Contract, Commerce and the Constitution—A Look at Economic Liberties and the Judiciary."

That the President was thus driven to distinguish economic from political freedom is a mark of our times, of course. Two hundred years ago one could scarcely imagine so peculiar a distinction, so entwined were economic and political liberty thought to be. Indeed, in the recently discovered working draft of the Bill of Rights, written by Roger Sherman in July of 1789, Article 2 declares that "[t]he people have certain natural rights which are retained by them when they enter into Society"; listed second in that Article, after rights of conscience but before rights of speech, writing, and publishing, are rights "of acquiring property, and of pursuing happiness & Safety,"[3] understood ordinarily as rights of pursuing economic well-being. In so conjoining economic and political liberties, as we would now speak, Sherman reflected simply the wisdom of his age. By way of evidence we need look no further than to John Locke, the philosophical father of our Revolution: "Lives, Liberties and Estates, which I call by the general Name, *Property*."[4]

There is more at issue here, of course, than a mere distinction, a semantic refinement. For behind this distinction is a set of ideas, a history of ideas—indeed, a whole vision that separates us from our forefathers. Yet the vision with which we are living today is increasingly being called into question: in economics, in law, in philosophy, the suspicion is developing that the Founders may have had the better of it—analytically, morally, and practically. A growing literature, pointing often to the opinions of our judiciary by way of evidence, is saying that along the way we lost our bearings.[5]

II. OUR IDEOLOGICAL ROOTS: INDIVIDUALISM

To explore these issues of ideology more fully, albeit briefly, we need to begin at the beginning, at our beginning, with the essence of the Founders' vision, nowhere set forth more clearly than by Thomas Jefferson in the Declaration of Independence. In the space of a mere seven phrases the Declaration distills the moral, political, and legal vision of the classical liberals, beginning, not surprisingly, on a point of epistemology, that the conclusions that follow are asserted not as empirical, much less as evaluative, but as "self-evident" truths, truths of reason. Far from the stuff of a living, evolving conception, these are the truths that speak eternally and unchangingly to the human condition, transcending both time and circumstance. The moral truths come first, beginning with the premise of moral equality: "that all Men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty, and the Pursuit of Happiness." Then come the political and, by implication, the legal truths: "that to secure these Rights, Governments are instituted among Men, deriving their just Powers from the Consent of the Governed." Finally, to make it clear that political power derives from and remains ultimately with the people, the Founders point to the right of the people to alter or to abolish their government and to institute new government in its place.

As has often been noted, what we have in these few, revolutionary phrases is nothing less than the inversion of the ancient order. No longer would politics come first, ethics second.[6] No longer would we begin with the group, the individual deriving his meaning, and his rights, from the group. No, we would begin instead with the individual. It is the individual who first has rights, which he has by nature, not by government grant. Indeed, it is government that gets its rights, or authority, by grant, from the individual, who yields up to government whatever rights he does, rights to be exercised on his behalf.[7] Thus it is that governments derive their *just* powers from the consent of the governed.

A. Political Legitimacy: Grounded in Consent

This final point—that to be just, government's power must be grounded in consent—marked a critical insight. Political legitimacy, the Founders were saying, is not a function of results but of process. It is not from the good deeds it does that government derives its legitimacy: if that were the case then the King's rule too would be legitimate, provided only that he produced good results—indeed, would be more legitimate than democratic rule if the results produced were better. No, political legitimacy has nothing at all to do with consequences, good or bad, but instead has everything to do with process. As with any ordinary contract, the distribution of power that results from the social contract will be legitimate only if the parties consent to that distribution. How else could individual autonomy, the right of the individual to rule himself, be respected and preserved unless the individuals over whom political power is exercised have consented to that exercise?

B. The Limits of Consent Theory

But if political legitimacy depends upon thus preserving individual autonomy, if powers of government are legitimate only if consented to, then a moment's reflection will suggest how difficult it is to establish political power that is morally legitimate. Because the argument here has been long known, if not widely known, let me simply summarize it.[8] It begins by amplifying the points just made, that if a particular grant of government power arises from unanimous consent, it is legitimate: that, after all, is precisely what "deriving their just powers from the consent of the governed" means. The problem arises when there is less than unanimous consent, which of course is almost always the case in the real world. For even if a supermajority consents, we are still left with the basic question: By what right does that ma-

jority exercise power over the minority when the minority, by definition, has not consented? If consent is the foundation of political legitimacy, then political power exercised over a minority on behalf of the majority is simply illegitimate. Since the numbers per se carry no moral weight—we don't suddenly get legitimacy once we've gotten over the 50 per cent threshold—the majority is in no better position than the King when it comes to justifying its exercise of power over the minority.

The classical solution, of course, was by way of a social contract with two levels of consent. Turning once again to process, this solution provided that political power exercised with less than unanimous consent would be legitimate if but only if there had been prior unanimous consent to be bound by the outcomes of subsequent votes. We still need unanimous consent, that is, but only to get the government off the ground, to give it legitimacy in the first place. After that, whatever rules had been unanimously agreed to at the outset must be followed, including decision-making rules that enable subsequent adoption of other rules by less than unanimous consent. Thus on any given vote the minority could be legitimately bound by the result because it had previously agreed to be so bound. Indeed, this is precisely the theory that underpins our government, at least as between the states. Article VII of the Constitution reads as follows: "The Ratification of the Conventions of nine States, shall be sufficient for the establishment of this Constitution *between the States so ratifying the same*" (emphasis added). Satisfaction of this provision enabled the Constitution to get off the ground. But by implication, states not so ratifying could not have been bound by the subsequent decisions of ratifying states.

While this solution may have worked among the states, especially since all did vote to ratify, the problem it poses for individuals is of quite a different order: that problem, quite simply, is that in point of historical fact, no such prior unanimous consent by individuals can be located, not even in America, where we came closer to it than perhaps anywhere else in the world. Moreover, even if we could locate such primordial unanimous consent, if we take the individual seriously, as indeed we do, then the theory affords no solution at all to the problem of how to bind succeeding generations: those who in fact consented could be bound, but they could hardly bind their heirs.

Consent theory finds its last refuge, then, in the idea of "tacit" consent: even if we don't give explicit consent, this argument runs, by staying we implicitly bind ourselves. But the argument from tacit consent is plausible only if we don't press it. Once we do, the problem becomes apparent. For it amounts to the majority saying to the minority: "Come under our rule or leave." It amounts, that is, to the majority putting the minority to a choice between two of its entitlements: its right not to come under the rule of the majority—the very hurdle the majority has to overcome if its power is to be legitimate; and its right to stay where it is, free from the will of the majority. To argue otherwise, quite simply, is to beg the very question at issue, namely, how does the majority come to have authority, or legitimate power, over the minority? The argument from tacit consent, in short, is patently circular.

What this all comes down to, then, is not a little disturbing to those who have grown up with the belief that democracy is the final word in matters of political legitimacy. Democracy may indeed be the best word we have, but it is not the final word. For if legitimacy can be derived neither from results nor even, as a practical matter, from process, then we are left with the conclusion that government per se has a certain air of illegitimacy about it. Yet the Founders seem to have understood this point, however disturbing it may be to some today. As Professor William Stoebuck has written, Locke's social-contract theory, which says that "[g]overnment is a servant, necessary but evil, to which its subjects have surrendered only what they must, and that grudgingly, . . . was the accepted theory of government when the [Constitution] was being hammered out."[9] In sum, the Founders understood both the moral virtues and the moral limits of democratic rule.

C. The Solution: Limited Government

If government is a necessary evil, then, necessary largely because of the practical problems

that surround attempts to secure our rights in a state of nature,[10] but evil because of the impossibility of satisfying the consent condition that alone would make it legitimate, what follows is as straightforward as it is compelling, namely, that government should be called upon to do no more than is necessary to enable it to carry out its principal purpose, securing our rights. From considerations of morality, from respect for the moral right of every individual to be free to live his own life, we may call upon government only in a limited way: we must settle, in short, for limited government, for to do otherwise is to violate the rights of those who ask only to be left alone.

The world that emerges from this vision is also straightforward. It is a world in which individuals are left free to pursue their own values, to live their own lives as they think best, to chart their own courses through life, alone or in association with others, free from government dictate or interference, provided only that in the process they do not violate the rights of others, which it is the business of government to prevent. Notice that there is no distinction here between economic and noneconomic pursuits. Why should there be? Provided, again, that they respect the rights of others, individuals or groups are free to pursue whatever ends they wish—artistic, entrepreneurial, political, eleemosynary, worthy or foolish. That, after all, is what freedom is all about. Notice too how different this conception of government is from the conception so common today: government is a necessary evil, instituted simply to secure our rights, not an instrument through which to pursue social goals, even worthy social goals. I will say more about this contrast shortly. For the moment, however, I want to draw very briefly a still sharper contrast, between the classical vision and the vision that is its polar opposite.[11]

III. THE OPPOSITE IDEOLOGY: COLLECTIVISM

A. Rights as a Product of Development

That opposite vision stems from Karl Marx, of course, at least in its modern version. In 1987 I had the privilege of attending the 43rd Session of the U.N. Human Rights Commission in Geneva, where I served as the political adviser to the head of the American delegation. Representing the Soviet Union at one point in those proceedings was Boris Kravtsov, the Soviet Minister of Justice, who told the assembly that in his country "insuring human rights was one of the main aims of social, political, and economic development." In so putting the matter, Mr. Kravtsov clearly was speaking of a very different conception of rights and of social organization than we have thus far been considering here. Rights, on this view, do not belong to individuals as such; rather, they are "by-products," if you will, of development. Indeed, Mr. Kravtsov went on to say: "Recently we gave certain collectives the right to participate in these developments." And again, "we are giving unions the right to participate in state and social life." Like the *ancien régime,* the Soviet government gives rights. Individuals do not have rights by nature; instead, they get them from government. And "government," Article 6 of the Soviet Constitution tells us, means the Communist Party.

What is most striking about this vision, because most fundamental, is that it begins not with the individual but with the group, as represented by the government, which inevitably means the Party. For all its pretense to historical progress, the system is thus a throwback to the ancient order, with the Party standing in the place of the King. The Party "determines the general perspectives of the development of society"—I quote here from Article 6 of the Soviet Constitution. As development progresses, presumably, "rights" to jobs, housing, and so on get distributed by the Party, all according to the plan. Social and economic development are thus conscious undertakings, centrally planned

by the Party, in pursuit of which the individual is an instrument to be used.

B. Using the Individual for the Common Good

Setting aside the economic impoverishment that necessarily accompanies central planning, I want to focus here on the moral impoverishment this vision entails. It begins, of course, with the sublimation of the individual, with the assumption that the individual has no rights that his government has not first given him, and the implicit assumption that government has rights to give out in the first place. But in making rights a function of development, the burden, if rights are to be insured, is placed upon continuous development; for without it, there would be no rights. This means, however, that if individuals are to have rights they will be obligated to contribute to this centrally planned development, however out of their hands the decisions and planning of the development may be. What started out as a *right* to work, then, has suddenly become a *duty* to work. Indeed, as has often been noted, the central moral problem with socialism is that it *uses* people. It treats individuals as means, not as ends—to be used in carrying out the Party's development plan.

The socialist system thus violates the cardinal principle of ethics, as articulated by John Locke, by Immanuel Kant, by every great religion, that the individual is not to be used, is not to be treated as a means, but rather is to be treated as an end in himself. He has a right to be so treated, a right to what is his, a right to chart his own course through life, a right not to be chained to the pursuit of someone else's vision, whether Marx's, or Lenin's, or Stalin's, or the Central Committee's, or whoever's. To so chain him, to so use him in pursuit of the chimera of development is to deny him his right to choose for himself, to strip him of his inherent dignity, to deny him his fundamental right to be free. Is it any wonder that around the world people have fled and are continuing to flee from socialist systems? For in the end, individuals cannot but choose for themselves. Either they flee, often at great, even tragic personal cost, or they resign themselves to lives of quiet desperation, serving a master they did not choose, leading a life they could not wish.

Now I have drawn this contrast not because I believe that in the 200 years since our founding we have come close to the Soviet model—let me be clear about that—but because the contrast between the vision of the Founders and the vision that is Soviet reality sharpens our appreciation of the essential moral issues. At the same time, a number of disturbing parallels have developed over these 200 years, if not in scope at least in kind, so much so that a decade ago we heard much about the convergence thesis, the idea that in their social and political organization the two societies were converging. In this decade the convergence thesis seems to have waned—in part, no doubt, because there are many who have come to realize that the Soviet Union, by its very structure, is indeed an evil empire. Nevertheless, the not unrelated moral equivalency thesis remains very much alive in many quarters, the idea that as a moral matter there is not much difference between the two societies, suggesting a substantial measure of confusion as to what the moral issues really are. Let us return, then, to the Founders' vision to see what has happened along the way that might help to account for this confusion.

IV. THE DEMISE OF THE CLASSICAL VISION

A. The Democratic March: From Rights to Results

The first thing that happened, one could say, was the demise of the natural rights foundation on which the Founders' entire vision rested. David Hume, the Scottish philosopher who died in the year America was born, prepared the ground for that demise when he observed that from factual propositions no normative conclusions could be drawn,[12] an epistemological observation so startling that it awakened Kant from his dogmatic slumber, as he later put it. But while Kant was struggling mightily to

restore the rational foundations of ethics, Jeremy Bentham, the father of British utilitarianism, was declaring that talk of moral or natural rights was "simple nonsense: natural and imprescriptible rights, rhetorical nonsense,—nonsense upon stilts."[13] Thus began the long emergence over the course of the nineteenth century and into the twentieth of utilitarianism, rooted not in reason but in values, which held that acts, or laws, or policies were just not by virtue of their respect for individual rights but by virtue of their serving to produce the greatest good for the greatest number. In America, especially as we worked our way into the twentieth century, utilitarianism had its counterpart in law in what Professor Robert Summers has called "pragmatic instrumentalism," the conception of law as an instrument for accomplishing social goals.[14] The Progressive Era was the intellectual seedbed for this view, although it reached fruition only with the New Deal.

By itself, however, pragmatic instrumentalism in law, even coupled with utilitarianism in ethics, could not have brought about this shift from rights to results. For results-based rationales of policy and law have always failed to deeply satisfy: first, because of the impossibility of computing the utilitarian calculus, owing to the incommensurability of interpersonal comparisons of utility;[15] second, because even if we could compute that calculus, we are still left with Hume's dilemma, that from factual knowledge of the greatest good for the greatest number it does not follow logically that we ought to pursue that good; and third, even if we could compute that calculus and could make that logical leap, we are left with a nagging doubt, even absent a well-grounded theory of rights, that pursuing that good, especially when doing so would be at the expense of some among us, would not be right, might even violate rights.

Enter, therefore, democratic theory, which emerged through the nineteenth and twentieth centuries as the handmaiden of utilitarianism and pragmatic instrumentalism. What democratic theory purported to supply was both a solution to the problem of making the utilitarian calculus—we find out what the greatest good for the greatest number is by taking a vote—and a moral rationale—democracy is merely the moral right of each to rule himself writ large. Armed with the explanatory and justificatory force of democratic theory, or so we believed, we could shift our focus from rights-based to results-based policy and law, we could shift from limited government, instituted to secure our rights, to expansive government, engaged to pursue our goals—we could shift, in short, from government as a necessary evil to government as an engine of good.

B. The Institutional Manifestation: Judicial Abdication

Because this shift, at bottom, was from a reason-based vision to a will-based vision, it is not surprising that as an institutional matter the locus of the evolution was in the Congress and the Executive, the will-based branches of government. With the growth of the democratic impetus and the increase in the scope of the franchise, the pressure grew to enact "the will of the people." Standing athwart this democratic engine over the years had been the judiciary, the reason-based branch of government. But even the judiciary was not immune to the march of ideas, especially in the absence of satisfactory countervailing ideas, and so in time it too joined in the procession, abandoning reason to will, nowhere captured more clearly, perhaps, than in Mr. Justice Holmes' famous dissent in the infamous *Lochner* case—or so the conventional characterization would have it.[16]

In *Lochner,* you will recall, the Court found that a New York State statute regulating the hours of employment of bakery workers violated the liberty of contract protected by the Fourteenth Amendment to the Constitution, prompting Holmes to declare, in dissent, that the case was "decided upon an economic theory which a large part of the country does not entertain" and to offer further that his "agreement or disagreement [with the theory] has nothing to do with the right of a majority to embody their opinions in the law."[17] Having thus characterized the Court's decision as grounded not on a legal and moral but on an economic theory, having then disparaged the

Court for reading its economic philosophy into the Constitution, Holmes proceeded to read out of the Constitution all economic substance, saying that "a constitution is not intended to embody a particular economic theory, whether of paternalism and the organic relation of the citizen to the state or of laissez faire."[18] In so emptying the Constitution, Holmes ignored a number of its powerful substantive clauses, of course, from the takings, to the contracts, to the privileges and immunities, to the due process of law clauses, not to mention the histories of their enactment, which would have given additional weight to this substantive understanding.[19] And in place of a substantive reading he erected "the right of a majority to embody their opinions in law," which of course is nowhere to be found in the Constitution and indeed was carefully constrained by the Founders.

So powerful was this majoritarian impulse, however, that in time it prevailed even with the judiciary. By the time we reached *Carolene Products*[20] in 1938, following *Nebbia*[21] in 1934 and *West Coast Hotel*[22] in 1937, the distinction between economic and political liberties was finally established, as was the idea that these "different" rights should be subject to different levels of judicial review—the operational manifestation of the distinction. Once again, this distinction and its operational manifestation, like Holmes' "right of the majority," was nowhere to be found in the Constitution. But ignoring this and oblivious to the moral limitations inherent in democratic theory itself, yet driven by the unrestrained democratic vision, the Court simply abdicated its responsibility to protect the rights of the minority in their economic activities. Rights of democratic process would be protected, for this was what the unrestrained vision called for; but rights of economic substance would go unprotected, for deciding these was what the process was all about.[23]

V. THE MARCH OF IDEAS: RESTORING OUR ROOTS

Thus have we continued to the present, but there are signs that changes may be in the offing. In 1984, for example the Supreme Court decided a case called *Hawaii Housing Authority* v. *Midkiff*,[24] reversing a Ninth Circuit opinion that had found unconstitutional a Hawaii statute that permitted the state to condemn private land not so that it could be converted to public use but so that it could be purchased by private tenants who occupied it. What was noteworthy about this case was not the Supreme Court's opinion—far from it—but the Ninth Circuit opinion the Court reversed, which had held that "it was the intention of the framers of the Constitution and the Fifth Amendment that this form of majoritarian tyranny should not occur."[25] That language, together with the Supreme Court's opinion to the contrary, prompted an outpouring of critical comment, all of which may have played into the Supreme Court's more recent decisions in the land use area, at least to the extent that the Court remains susceptible to the march of ideas. I allude here to the *First English Evangelical Church*[26] and to the *Nollan*[27] decisions in 1987, both of which appear to be moving back toward a regime of restraint on public power over private individuals in the economic domain.[28]

And why should the judiciary not be susceptible to the march of ideas if indeed it is our reason-based institution. Earlier I noted that the rise of utilitarianism, pragmatic instrumentalism, and democratic theory was unaccompanied by satisfactory countervailing ideas. Well, that has changed in recent years. On the critical side, the idea that democracy affords a solution to the problem of deriving the utilitarian calculus has been exposed by the work of decision theorists, including those working in the area of public choice.[29] And in moral theory the idea that democratic rule is self-rule writ large has long been exploded, as earlier discussed. But on the constructive side also, much work has been done, aimed at developing the foundations for natural rights theory that admittedly were not there at our founding.[30]

All of which should encourage those judges who are disturbed by the march of the public domain to dip into this literature, the better to

gain the intellectual confidence that is helpful when standing against this march.[31] For the ultimate outcome of the march of the public domain is not a pretty picture, as earlier outlined. When all is public then by definition there is no private domain, no place to go to escape the public demand, as those who manage to flee such regimes will attest. By the design of our system we depend upon an unelected judiciary to brake the democratic engine, to protect the right of the individual, alone or in association with others, to live his own life, free from tyranny, free even from majoritarian tyranny. That was the original vision. It continues today to be the only vision that can ultimately be justified. □

1. Birdzell, "Constitutionalizing the Corporation: The Case for the Federal Chartering of Giant Corporations," 32 *Bus. Law.* 317 (1976).

2. Remarks by President Reagan to the citizens of Port Washington, Wisconsin (July 27, 1987). White House Press Release.

3. "Handwritten Draft of a Bill of Rights Found," *The New York Times,* July 29, 1987, §A, at 1.

4. J. Locke, *The Second Treatise of Government* §123 (P. Laslett ed. 1966).

5. *See, e.g.,* B. Siegan, *Economic Liberties and the Constitution* (1980); *Economic Liberties and the Judiciary* (J. Dorn & H. Manne eds. 1987); *Public Choice and Constitutional Economics* (J. Gwartney & R. Wagner, eds. 1988).

6. *Cf.* Aristotle, *Nicomachean Ethics,* Bk. I, ch. 2.

7. *See* R. Nozick, *Anarchy, State, and Utopia* 6 (1974). *Cf.* the text at note 3, *supra.*

8. *See* Nozick, *supra* note 7; R. Wolfe, *In Defense of Anarchism* (1970).

9. Stoebuck, "A General Theory of Eminent Domain," 47 *Wash. L. Rev.* 553, 608 (1972).

10. These practical problems are surveyed in Locke, *supra* note 4, and Nozick, *supra* note 7.

11. The contrast that immediately follows draws from my monograph *Human Rights and Politico-Economic Systems,* the Cato Institute, Washington, D.C., 1988.

12. D. Hume, *Treatise on Human Nature,* 469–70 (Selby-Bigge ed. 1888).

13. J. Bentham, Anarchical Fallacies, in 2 *Collected Works* 501 (Bowring ed. 1843).

14. Summers, "Pragmatic Instrumentalism: America's Leading Theory of Law," 5 *Cornell L.F.* 15 (1978).

15. The classic attempt was by Henry Sidgwick, *The Methods of Ethics* (7th ed. 1907); *See* A. Donagan, *The Theory of Morality* (1977).

16. *Lochner* v. *New York,* 198 U.S. 45 (1905).

17. *Id.* at 75.

18. *Id.*

19. See especially Siegan, *supra* note 5; R. Epstein, *Takings: Private Property and the Power of Eminent Domain* (1985).

20. *United States v. Carolene Products Co.,* 303 U.S. 144 (1938).

21. *Nebbia* v. *New York,* 291 U.S. 502 (1934).

22. *West Coast Hotel* v. *Parrish,* 300 U.S. 379 (1937).

23. For a contemporary version of this view *see* J. Ely, *Democracy and Distrust* (1980).

24. 467 U.S. 229 (1984).

25. *Midkiff* v. *Tom,* 702 F.2d. 788, 790 (1983).

26. *First English Evangelical Lutheran Church of Glendale* v. *County of Los Angeles, California,* 107 S. Ct. 2378 (1987).

27. *Nollan v. California Coastal Commission,* 107 S. Ct. 3141 (1987).

28. For an outline of a resolution of the takings question *see* my "Property Rights, Takings, and a Free Society," 6 *Harv. J. L. Pub. Policy* 165 (1983).

29. *See, e.g.,* K. Arrow, *Social Choice and Individual Values* (2nd ed. 1963); Riker, "Implications from the Disequilibrium of Majority Rule for the Study of Institutions," 74 *Am. Pol. Sci. Rev.* 432 (1980); and the classic by J. Buchanan and G. Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (1962).

30. *See, e.g.,* A. Gewirth, *Reason and Morality* (1978). *Cf.* R. Pilon, *A Theory of Rights: Toward Limited Government* (1979) (Ph.D. dissertation, University of Chicago). For an application in the area of economic liberty, *see* Pilon, "Corporations and Rights: On Treating Corporate People Justly," 13 *Ga. L. Rev.* 1245 (1979).

31. I have discussed the issues of judicial review more fully in "On the Foundations of Justice," 17 *The Intercollegiate Rev.* 3 (1981); "Legislative Activism, Judicial Activism, and the Decline of Private Sovereignty," in *Economic Liberties and the Judiciary, supra* note 5, at 183.

Overbearing Majorities

IDEAS ON LIBERTY

"Wherever the real power in a Government lies, there is the danger of oppression. In our Governments the real power lies in the majority of the Community, and the invasion of private rights is *chiefly* to be apprehended, not from acts of Government contrary to the sense of its Constituents, but from acts in which the Government is the mere instrument of the major number of the Constituents."

—JAMES MADISON, *in a letter to Thomas Jefferson, October 17, 1788*

The *Monitor*: America's Socialized Shipwreck

by Gary Gentile

For more than two centuries, Americans have defended the rights of sailors to move freely upon the open seas. But now, the international waters again are under attack. This time, however, we are fighting for freedom *under* the seas. And this time, the usurpers are minions within our own government.

At the center of the controversy lies the *Monitor,* one of the first ironclad warships, which was built for the Union navy by John Ericsson. Launched in January 1862, the *Monitor* was 179 feet long, weighed 1,200 tons, and featured a revolving turret containing two 11-inch guns. She was powered by steam, and had a screw propeller.

On March 8, 1862, the *Monitor* engaged the Confederate ironclad *Virginia* (formerly the *Merrimack*) near Hampton Roads, Virginia. In a historic struggle, the two ironclads fought a four-hour duel, which ended in a draw. In May 1862, when the Confederates abandoned Norfolk, the *Virginia* was run ashore by her crew and burned. In December 1862, the *Monitor* foundered and sank in heavy seas off Cape Hatteras, North Carolina. This, it would seem, was the end of the *Monitor* and *Merrimack.*

However, the U.S. Navy knew the approximate location of the *Monitor*. But without adequate financing for an in-depth survey, the Navy was unable to find the wreck.

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The Navy's primary concern was not who got credit for the find, but that the shipwreck be found. In 1953, to provide incentives for the private sector to conduct scanning operations, the Navy struck the vessel from the Naval Register and abandoned all salvage claims.

For two decades a veritable flotilla searched the shoals off Cape Hatteras, but it was not until 1973 that the Duke University research vessel *Eastward* located and tentatively identified the remains of the *Monitor* 16 miles offshore. The following year the site was revisited, and positive identification was obtained when the research vessel *Alcoa Seaprobe* took several thousand underwater pictures which were assembled into a photomosaic by Navy specialists.

Almost immediately, several government agencies began vying for control of the *Monitor* wreck. The winner was the National Oceanic and Atmospheric Administration (NOAA), under the auspices of the Department of Commerce. Although the ironclad did not fit the criteria of any Act of Congress, the Marine Protection, Research, and Sanctuaries Act was the shielding mechanism deemed most appropriate. The *Monitor* became a sanctuary in the middle of a one-mile diameter tract of sea bed and the accompanying column of water. It was designated the first marine sanctuary, and came to be known as the *Monitor* National Marine Sanctuary (MNMS). The *Monitor* had at last found a home—or was it a jail?

The *Monitor* as a marine sanctuary lies on shaky ground—and in legally turbulent water.

By international agreement, territorial rights extend to 12 nautical miles from the mean high water mark. In this respect, the U.S. generously claims only three miles of territorial waters. In either case, the *Monitor* resides on land not owned by the U.S., and which is outside U.S. jurisdiction.

In addition, because the wreck was legally abandoned, its status falls under the common law principle of the maritime law of salvage, which, although expressed by various judges in different forms, generally provides that "the finder or salvor of abandoned property at sea who first reduces that property to his possession may keep that property." (*Treasure Salvors III* case) In the 1981 *Cobb Coin* case, U.S. District Court Judge James Lawrence King further stipulated that "salvage law permits one whose salvage efforts are continuous and reasonably diligent to work a wreck site to the exclusion of others." In other words, the backers of the *Eastward* expedition could have kept a substantial claim over the wreck had they continued to work it. Since they did not, the wreck is unclaimed property. Anyone may salvage it.

Anyone, that is, except U.S. citizens. They are not even allowed to look at the wreck, much less recover anything from it.

While the stipulated goals of the National Marine Sanctuary Program are, in part, to "enhance public awareness, understanding, and wise use of the marine environment," and to "provide for maximum compatible public and private use," the case of the lost shipwreck has been wrapped in rolls of extremely sticky red tape.

Frustration and Delay

Four years ago, when I first applied to the MNMS for a permit to dive the *Monitor*, it was with full confidence of receiving prompt and professional aid. My simple letter of intent stated my purpose and objectives—to dive the wreck of the *Monitor* in order to take pictures of the historic site. What I got was years of frustration and delay. At first, I received no response to my queries. Later, I obtained a grudging acknowledgment. Finally, intentionally rigid restrictions were imposed which would make compliance difficult and expensive. But, because I wanted to dive the wreck, I proceeded.

I wrote a six-page monograph, but MNMS found it inadequate. Eventually, this grew into a proposal of more than 100 pages in which I had to: itemize every piece of equipment I intended to take, and describe the function and use of each; submit a detailed cruise plan and time table of events; explain in intricate detail the techniques of scuba diving, even the most basic; furnish resumés and complete medical examinations for each participant; specify my goals, with no allowed deviation; and provide proof of funding. Doing this, I felt more like the board of directors of a university sponsoring an expedition than an individual desiring merely to see a sanctuary that supposedly had been put aside for my benefit.

During this time, not only did I receive no cooperation from MNMS, but the number of unanswered questions posed in my many letters was growing. And only one letter in four was answered. Worse, as I met the demands imposed upon me, the agency invoked discretionary procedures to conjure up more stumbling blocks.

In short, my permit application was denied. I was cited for safety violations due to depth (the *Monitor* lies in 220 feet of water) and for having photographic objectives which already had been met by previous NOAA expeditions. The *Monitor* National Marine Sanctuary took no cognizance of my experience and level of expertise: more than 700 open-ocean, decompression dives, of which nearly a hundred were made in depths equivalent to the *Monitor*.

In addition, MNMS officials assert that my photographic efforts on the *Monitor* must produce viable results which in some way benefit the Sanctuary. This obviates the ultimate aim of the sanctuary program: that sanctuaries, like parks, exist for the benefit of the people, not the reverse. Even if I chose not to make photographic documentation, this should not rule out my wanting to dive the *Monitor* because, like Mount Everest, "it is there."

Following administrative procedure, I appealed the denial.

But my involvement with MNMS did not

end there. Because of my tenacity, I became the focus of an investigation. Upon learning that I intended to dive in North Carolina close to the *Monitor* site, a MNMS spokesman alerted the Coast Guard and threatened me with arrest and a $50,000 fine should I be caught within Sanctuary boundaries. This brought up a curious situation: despite numerous requests for precise navigational coordinates, which I had needed for my proposal to calculate running times from shore to wreck, MNMS had steadfastly refused to give them to me. Now it enjoined me to stay away from a spot whose location I did not know. Nevertheless, officers of the Marine Fisheries Department were waiting for my chartered boat every day when it docked. They inspected our gear for artifacts which might have been old enough to have come from the Civil War ironclad. The surveillance continues.

Denying Access

I once cajoled an MNMS spokesman into admitting that Sanctuary regulations had been made purposely stringent so as to deny public access. The MNMS desires sole proprietorship over the site; it wants to have the only photographs of the wreck; and it wants complete control over publicity. It does not want to share the *Monitor* experience. Not is it committed to having the wreck fully documented—it wants only that such documentation be generated within its own bureaucracy, free from outside competition.

The condition of the *Monitor* today is not the same as it was yesterday, last year, or at any other time in its history. The sea is ever changing, ever destroying. As a shipwreck disintegrates, it passes before our eyes like a movie in extreme slow motion. Each frame is ephemeral, existing only for a brief instant in time, and must be studied before it dissolves.

Even the most naive must admit that the *Monitor* does not display the same graceful curves as when it slid down the ways in 1862. Its turret and Dahlgren guns are no longer thrust out defiantly against foes such as the *Virginia*. Its destruction is a continuous and ongoing process that is not stopped by the passing of laws, or governmental intervention.

My case seemed totally lost until I met Peter Hess through the Atlantic Alliance for Maritime Heritage Conservation. This body of volunteers has lobbied for years against the many bills which seek to take, not just the *Monitor,* but all shipwrecks out of the public domain, and place them under government control. Although the prime goal of the Alliance is to teach underwater archaeology to interested divers around the nation, it has taken a staunch position in protecting people's rights to dive shipwrecks.

Peter Hess is a diver, shipwreck historian, amateur archaeologist, and an attorney with a background in maritime law. He has been intimately involved with diving legislation, has frequently advised on Alliance policy, and has testified in Senate hearings against the Abandoned Shipwreck Acts, which aim to place all shipwrecks under government control. He followed my *Monitor* pursuits with fervent concern. When my bid for justice died, he put life back into my sagging spirit.

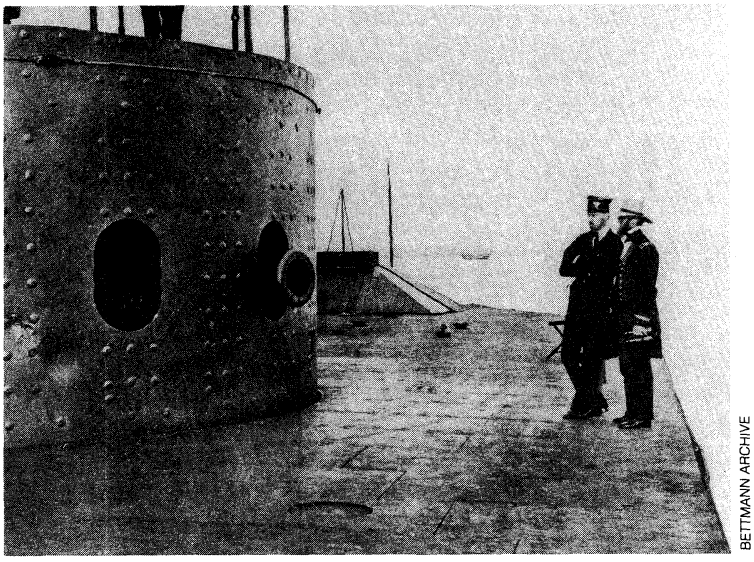
After listening to my story and reading my correspondence, Peter was keen enough to note many improprieties in NOAA's handling of my permit application: improper delegation of authority, bias among MNMS staff members who had personal ambitions concerning the disposition of the *Monitor,* disinclination to consider proven scuba diving methods, and lack of impartial review. The denial of my permit was arbitrary and capricious.

Working together, we filed a complaint for declaratory judgment and injunctive relief in the United States District Court for the Eastern District of Pennsylvania. NOAA and MNMS were forced to commit to the administrative record such evidence as existed in their files. However, so vehemently did they resist interrogation that they filed a motion to have any further discoveries kept out of the Court's eyes.

Even so, several things became immediately clear: that, although mandated by Federal regulation, my permit application had not been circulated among members of either the Scientific Review Board or the Advisory Council on Historic Preservation—those very two committees for whom I had written my proposal in such painstaking detail; that, after stipulating that my photographic objectives already had been

"There is not much left of the *Monitor*. Its once sleek hull is pockmarked by the ravages of the sea: it is a mere skeleton of itself, unrecognizable to all but experts."

(right) The Monitor *in its prime.*



BETTMANN ARCHIVE

met by previous (government-sponsored) expeditions, NOAA spent $1.8 million of taxpayers' money on another photographic expedition; that, while not allowing my support vessel to place a 30-pound anchor near the wreck, in order to facilitate diver access and afford increased safety, NOAA permitted its own expedition to drop four *six-ton* anchors on the site, even though it used no divers and required no safety measures; that, after all the rhetoric aimed at protecting a valuable marine resource, NOAA let its own members fish the wreck.

MNMS had pigeonholed my entire project right from the start, and never had any intention of letting it get a proper review.

I realized the full absurdity of this situation during a recent visit to Halifax. My Nova Scotian friends were dumbfounded to learn that they could take their boat down the coast and dive the *Monitor* at any time. And no one, Coast Guard included, could stop them. Canadians, or the citizens of any other nation, are not bound by U.S. mandates when they are in international waters. The only people prevented from visiting the *Monitor* are U.S. citizens.

There is not much left of the *Monitor*. Its once sleek hull is pockmarked by the ravages of the sea: it is a mere skeleton of itself, unrecognizable to all but experts. The minimum estimate for raising the hulk is upwards of $40 million, not counting the cost of preservation, housing, and eternal maintenance—an unwarranted expense for archaeological provenience considering that, with all the photographs, plans, and written records of the *Monitor*, there is probably nothing further to be learned.

The only thing ironclad about the *Monitor* today is MNMS's stand on no access. Instead of bouncing off cannon balls and solid shot, present arrangements deny access to the very people who are most willing to spend their own money and expend their own efforts to bring to the public the images of their adventures.

The time is long overdue to re-evaluate the entire status of the *Monitor*. Why should Americans be forbidden to dive the wreck? Are there other ways to manage the *Monitor* which would involve less red tape? Why, in fact, should the Federal government maintain ownership and control? Wouldn't a private owner or salvager have strong incentives to put the remains of the *Monitor* to the best possible use?

In a free society, the purpose of the State is not to own or to rule, but to protect the rights and property of its citizens. Abandoned shipwrecks, by the very nature of abandonment, are not the possessions of the government merely by the fact of their existence. If shipwrecks belong to anyone, it is to those individuals with the will and the incentive to dive on them at their own cost and expenditure of time. The confiscation of this property under the guise of "the public good," coupled with the subsequent denial of public access, violates the most basic moral principles. □

Charles Schwab and the Steel Industry

by Burt Folsom

When asked for the secret of his success in the steel industry, Charles Schwab (1862-1939) always talked about making the most with what you have, using praise, not criticism, giving liberal bonuses for work well done, and "appeal[ing] to the American spirit of conquest in my men, the spirit of doing things better than anyone has ever done them before." He liked to tell this story about how he handled an unproductive steel mill:

> I had a mill manager who was finely educated, thoroughly capable and master of every detail of the business. But he seemed unable to inspire his men to do their best.
>
> "How is it that a man as able as you," I asked him one day, "cannot make this mill turn out what it should?"
>
> "I don't know," he replied. "I have coaxed the men; I have pushed them, I have sworn at them. I have done everything in my power. Yet they will not produce."
>
> It was near the end of the day; in a few minutes the night force would come on duty. I turned to a workman who was standing beside one of the red-mouthed furnaces and asked him for a piece of chalk.
>
> "How many heats has your shift made today?" I queried.
>
> "Six," he replied.
>
> I chalked a big "6" on the floor, and then passed along without another word. When the night shift came in they saw the "6" and asked about it.
>
> "The big boss was in here today," said the day men. "He asked us how many heats we had made, and we told him six. He chalked it down."
>
> The next morning I passed through the same mill. I saw that the "6" had been rubbed out and a big "7" written instead. The night shift had announced itself. That night I went back. The "7" had been erased, and a "10" swaggered in its place. The day force recognized no superiors. Thus a fine competition was started, and it went on until this mill, formerly the poorest producer, was turning out more than any other mill in the plant. (Charles M. Schwab, *Succeeding with What You Have* [New York: Century Co., 1917], pp. 39-41)

Schwab showed the ability to find solutions to problems even as a lad growing up in Loretto, Pennsylvania. According to one of his teachers, "Charlie was a boy who never said, 'I don't know.' He went on the principle of pretend that you know and if you don't, find out mighty quick." Schwab knew early that he would have to live by his wits; his parents and immigrant grandparents weaved and traded wool products, jobs which put food on the table but not much money in the bank. Young Charlie, therefore, started work early in life. In one job he was a "singing cabby": he drove passengers from nearby Cresson to Loretto and entertained them with ballads along the way. One of his passengers, impressed with the gre-

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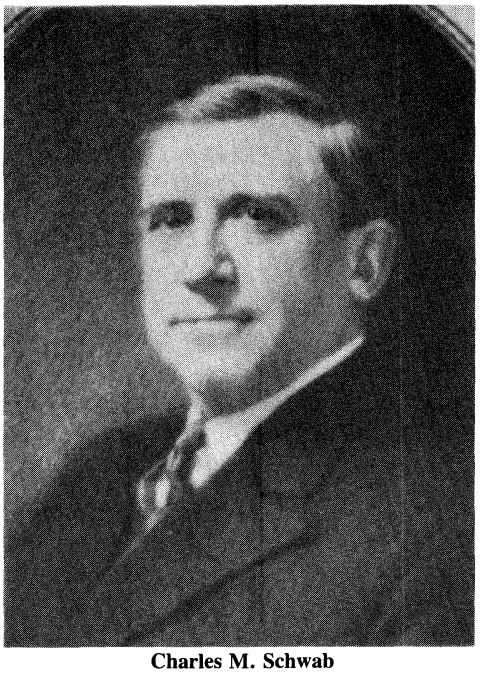


NEW YORK HISTORICAL SOCIETY

Charles M. Schwab (1862-1939)

garious youth, gave him a travel book. Schwab later said, "It opened my eyes to the glories of the outside world, and stimulated my imagination tremendously." Soon, Loretto, Pennsylvania, population 300, would be too small to contain the ambitious Schwab. With his parents' blessing, he left home at age 17 to clerk in a general store in Braddock, a suburb of Pittsburgh.

Braddock was a steel town, varied in its cultural and urban life. Working in the store, young Charlie often pleased customers with his good looks, wit, and charm; one man whom he impressed was William "Captain Bill" Jones, the mill superintendent at Braddock for Carnegie Steel. Jones offered Schwab a job as a stake driver for the engineering corps who designed plans for building furnaces. Schwab accepted, proved himself capable, and soon became a draftsman. Here, he worked overtime to master his craft; within six months he became Jones' right-hand man at the mill. As Jones' messenger boy, Schwab came into contact with the mill owner, the Scottish immigrant Andrew Carnegie. Carnegie took a special liking to Schwab, who wisely spent some of his off hours playing Scottish ballads on Carnegie's piano.

Schwab worked hard to please Jones and Carnegie. Doing so allowed him to advance in the Carnegie organization. Fortunately for Schwab, Carnegie did not recruit his leaders on the basis of wealth or family standing. He used a merit system; he wanted people who could make the best steel possible at the lowest price. To succeed under Carnegie's system, Schwab would have to master the methods of steel production.

The Carnegie System

Carnegie stressed cutting costs: in fact his motto was "Watch the costs and the profits will take care of themselves." This meant hard work in innovating, accounting, and managing. Purchases, for example, were made in bulk to achieve economies of scale. Also, Carnegie strived for vertical integration, the control of his steel business from the buying of raw materials to the marketing of finished steel.

At the heart of Carnegie's system were bonuses and partnerships for those who excelled. Strong incentives were given employees who could figure out how to save on iron ore, coke, and limestone; or how to produce a harder, cheaper steel; or how to capture new markets for steel. Carnegie explained that success "flows from having interested exceptional men in our service; thus only can we *develop ability* and hold it in our service." In fact, Carnegie said, "Every year should be marked by the promotion of one or more of our young men."

Captain Jones had risen to mill superintendent this way. Among other things he had invented the Jones mixer, a device that cut costs in the transferring of steel from the blast furnace to the Bessemer converter. For his inventions and know-how, Carnegie paid him the highest salary in the business, $25,000—the same salary as that of the President of the United States.

Schwab rose through the ranks just as Jones did. He completed small tasks and was given larger ones. At age 23, he designed and built a bridge over the Baltimore and Ohio Railroad tracks; he saved time and money doing the job and received as a bonus ten $20 gold pieces from Carnegie himself. Other assignments followed: he installed meters in the factories and

Andrew Carnegie (1835-1919)

reduced waste of natural gas; he redesigned a rail-finishing department and saved 10 cents per ton of steel; he helped in calming down workers during a violent strike in the Homestead plant. When Captain Jones died in a blast furnace explosion in 1889, Schwab was the logical choice for superintendent at Braddock.

Gregarious and competent, Schwab became Carnegie's problem solver. For example, the workers at Braddock were turning out "seconds," or substandard rails. Schwab's solution: give $20 cash bonuses to those steelmakers producing the fewest seconds. The quality of the rails shot up and the resulting increase in profits more than paid the bonuses given. No wonder that Carnegie soon gave Schwab a small partnership in Carnegie Steel, with the promise of more to come if he could keep producing. Carnegie even wrote one of his senior partners, Henry Clay Frick, that Schwab "gives every promise of being the man we have long desired" eventually to run the business.

Schwab idolized Carnegie and found him amazing to watch. Carnegie's efficiency and his thorough knowledge of the industry made him a terror among fellow steel producers. He spied on them, used their annual reports against them, and even wrote them to secure information on costs of production. Meanwhile, Carnegie Steel was a closed corporation; he told outsiders nothing of his costs or his future plans. Carnegie disdained "pools," secret agreements among competitors to divide up the market and keep prices high. Pools were for the weak; Carnegie wanted to "scoop the market [and] run the mills full."

Not that Carnegie didn't use friendships and other means to help him. In bidding on a large Union Pacific contract for rails, he may have outmaneuvered the veteran Scranton family. Joseph Scranton was a director of the Union Pacific as well as president of the Lackawanna Iron and Coal Company. But Carnegie had done a favor for Sidney Dillon, the president of the Union Pacific, and Dillon agreed to give Carnegie the contract if he would match the lowest bid.

Carnegie vs. the Scrantons

In the case of the Scrantons, Carnegie showed no mercy. When Carnegie went into the steel business in 1872, he was told that he could never compete against the Lackawanna Company; Joseph Scranton was a founding father of American rail-making; he had a generation of experience making rails. But that year Joseph Scranton died, and his sons William and Walter would be the ones to challenge Carnegie: first with the Lackawanna Company, then with their Scranton Steel Company. Carnegie and the Scrantons joined the Bessemer Steel Association in 1875, but their approaches were different: the Scrantons wanted a pool, but Carnegie told them and others that unless he got the largest share he would "withdraw from it and undersell you all in the market—and make good money doing it."

The Scrantons and the others were bluffed by Carnegie and gave him his way. Carnegie then studied the Scrantons and learned their strengths and weaknesses. He discovered that they (and others) were discarding the thin steel shavings, called "scale," that fell on the floor when the steel passed through the rollers. When he learned this, he regularly sent a man to Scranton to cart away tons of the Scrantons' scale, almost free of charge, and brought it to

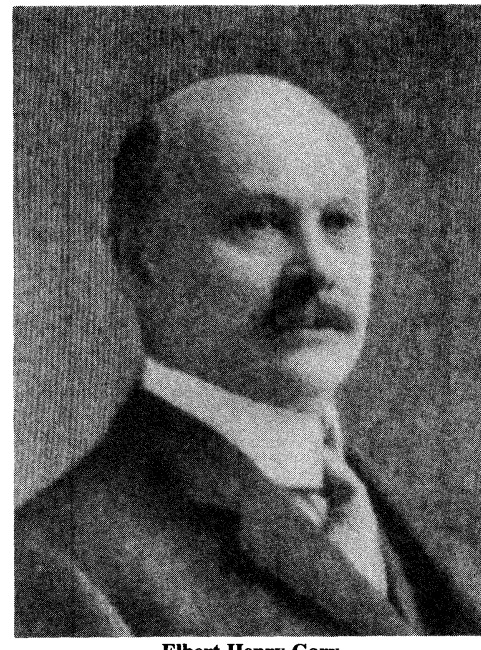
Pittsburgh to use in making rails for Carnegie Steel.

As Carnegie moved to the top of the American steel business, Schwab watched, learned, and proved himself time and again. In 1897, the 35-year-old Schwab became president of Carnegie Steel and the two men ran the company together. Business was never better. Schwab put in 16 new furnaces at the Homestead plant, and costs per ton of finished steel fell 34 per cent in one year. To promote espirit de corps, Schwab held Saturday meetings with all of his superintendents to work out problems. Meanwhile, the results of large-scale production took hold: the cost of making rails fell from $28 to $11.50 per ton between 1880 and 1900, but the profits from the larger volume of business went from $2 million in 1888 to $4 million in 1894, to $40 million in 1900. Some people wondered if Carnegie Steel might soon capture the steel trade of the entire world.

Such speculating was premature. The next year, at age 65, Carnegie retired and, with Schwab as his emissary, sold Carnegie Steel to J. P. Morgan for $480 million. Morgan then combined Carnegie Steel with other companies to create U.S. Steel, the first billion-dollar company in American history. The choice for president of the company: Charles Schwab.

Reporters and critics condemned "The Steel Trust," as they called U.S. Steel, for its size and its potential to monopolize. Who would be able to compete, they asked, with such a large vertically integrated company? At his disposal, Schwab would have 213 steel mills and transportation companies, 41 iron ore mines, and 57,000 acres of coal land—enough, critics charged, to dwarf competitors and keep prices high.

Schwab discovered, however, that he would not be able to use the Carnegie system at U.S. Steel. In fact, he would not have authority to run the company at all. Morgan and his friend Elbert Gary had organized U.S. Steel so that an executive committee, headed by Gary, and the board of directors would set the policies of the company; Schwab, as president, would carry them out. Morgan and Gary were interested in business stability, not in innovating or in cutting the price of steel. For example, when Schwab wanted to secure more ore land, Gary said no. He also opposed price-cutting, aggressive marketing, giving bonuses, and adopting new technology. Schwab later said, "Gary, who had no real knowledge of the steel business, forever opposed me on some of the methods and principles that I had seen worked out with Carnegie—methods that had made the Carnegie Company the most successful in the world."



Elbert Henry Gary
(1846-1927)
Gary, Indiana, a U.S. Steel "town," was named for him.

Personal Problems

Schwab's personal life, more than disputes over policy, seems to have led to his downfall at U.S. Steel. He showed he had the values of a dissipater as well as those of an entrepreneur. When Carnegie was in control, Schwab consciously restrained his extravagant tastes; Carnegie deplored living beyond one's income, gambling, and adultery. But out from under Carnegie's grip, Schwab engaged in all three and almost ruined his marriage and his career. In New York City, Schwab built "Riverside," a gargantuan mansion, which consumed one whole block of the city and $7 million of his cash. He also gambled at Monte Carlo, which

made bad newspaper copy and cost him credibility. Finally, he had an affair with a nurse, which resulted in a child. Though Schwab hid this from the press, he could not do so from his wife, Rana. The strain of his adulterous behavior, combined with the pressure of Monte Carlo, the expense of Riverside, and the barbs from Elbert Gary wrecked Schwab's health. He went to Europe to recover and, in 1904, resigned as president of U.S. Steel.

Schwab, the man who said, "I cannot fail," seemed to have failed. He was depressed for months. Even Carnegie repudiated Schwab and this added to the pain. During his troubles he had insomnia, he lost weight, his arms and legs were regularly numb, and sometimes he fainted. His wife forgave him for his adultery and this no doubt eased the strain; but she was still not happy because she wanted a child of her own and never had one. She didn't covet the extravagant life, so dear to her husband, and she spent many lonely days at Riverside.

Schwab was out at U.S. Steel, but he already had the makings for a comeback. When he was president of U.S. Steel, Schwab had bought Bethlehem Steel as a private investment. He was criticized for this, especially when he merged Bethlehem Steel with some unsound companies into an unprofitable shipbuilding trust. This merger eventually collapsed; but when Schwab stepped down at U.S. Steel, he still had Bethlehem Steel as his own property. The demotion from being president of a company worth over one billion dollars, to being president of one worth less than nine million dollars would have embarrassed some men, but not Schwab. He would have full control in running the company and would succeed or fail on his own abilities.

Before Schwab took over Bethlehem Steel, its future had not looked promising. It had been founded in 1857 and soon produced rails for the Lehigh Valley Railroad. This was more than coincidence because entrepreneur Asa Packer, who had built the Lehigh Valley Railroad, held a large interest in what was then Bethlehem Iron. Packer, a Connecticut Yankee, had the vision and ability to promote both of these investments and make them profitable. His rise from carpenter to railroad tycoon had made him a legend in Pennsylvania; he was worth $17 million by the late 1870s. When he died in 1879, his sons, sons-in-law, and nephews took over his investments, but did not have the success that Packer did. The Lehigh Valley Railroad floundered and went into receivership in the Panic of 1893. Bethlehem Iron almost shared the same fate.

Led by Philadelphians and the Packer group, Bethlehem Iron became very conservative after Packer's death. The younger leaders single-mindedly produced rails, even though Carnegie was doing it cheaper, and they had the expense of importing most of their iron ore from Cuba. They escaped a price squeeze in 1885 when, reluctantly, they shifted from making rails to producing military ordnance, which commanded a higher price per ton than rails. Such an imaginative strategy, as one might expect, did not originate within the Packer group; in fact, they resisted it until declining profits on rails presented them with no alternative.

From Rails to Armor Plate

The wise, if belated, switch from rails to gun-forgings and armor plate led to profits because Bethlehem Iron was the only bidder on its first government contract for ordnance in 1887. Other contracts were forthcoming and Bethlehem Iron "established a reputation for quality and reliability," if not for aggressiveness and efficiency. Regarding the last, its operations were so inefficient that the company in 1898 hired Frederick W. Taylor, master of scientific management, to suggest ways of improving worker productivity. Yet the Packer group soon became hostile to Taylor's cost-cutting ideas. Of one suggestion to reduce the number of workers handling raw materials, Taylor observed that the owners "did not wish me, as they said, to depopulate South Bethlehem." He further commented, "They owned all the houses in South Bethlehem and the company stores and when they saw we [Taylor and his assistants] were cutting the labor force down to about one-fourth, they did not want it." They also rejected Taylor's suggestions to standardize job functions and give raises to key personnel.

Surviving, then, on government contracts, Bethlehem Iron stumbled into the twentieth

century—a profitable operation in spite of itself. In the midst of this conservatism, Schwab came to Bethlehem in 1904 and boldly announced that he would "make the Bethlehem plant the greatest armor plate and gun factory in the world." Taking the helm, Schwab "backed Bethlehem with every dollar I could borrow." This backing included buying new branch plants and closing unprofitable ones, getting new contracts by selling aggressively, and reorganizing the company as Bethlehem Steel. Planning for the future, Schwab bought large tracts of land for the company east of South Bethlehem. He also bought or leased more ore land and mechanized the company's Cuban iron fields to spur production there.

Schwab's entrepreneurship clashed with the Packer group's cautiousness right from the start. As one historian said, "Many of the veteran Bethlehem executives preferred the old, pre-Taylor and pre-Schwab way." Soon after arriving in South Bethlehem, Schwab ousted the inbred Packer group from authority. In the new president's remarkable words, "I selected 15 young men right out of the mill and made them my partners." Two of these "partners" were Eugene Grace, the son of a sea captain, and Archibald Johnston, a local Moravian. They later became presidents of Bethlehem Steel.

After reorganization, Schwab wanted to diversify his company and challenge U.S. Steel. To do this, he began making rails and moving Bethlehem Steel away from its dependence on government contracts. Schwab adopted open-hearth technology because it produced better rails than the Bessemer system did. As historian Robert Hessen notes:

> U.S. Steel, the nation's largest rail producer, did not follow Schwab's lead; it would have had to replace its Bessemer facilities with open hearth equipment. Being a late starter, Bethlehem enjoyed a clear advantage: with no heavy investment in obsolete equipment to protect, it could adopt the newest and most efficient technological processes. (*Steel Titan: The Life of Charles M. Schwab* [Oxford University Press, 1975], p. 169).

Schwab's reorganization of the Cuban ore mines also improved Bethlehem's competitive position at the expense of U.S. Steel.

> Cuban ore was richer in iron and lower in phosphorus than was the Mesabi range ore used by U.S. Steel. It also had another advantage: it contained large amounts of nickel, so that Bethlehem could produce nickel steel at no extra cost. For a ton of iron Bethlehem's cost was $4.31; U.S. Steel's was $7.10. (*Steel Titan: The Life of Charles M. Schwab,* p. 171)

Now that Schwab was running an efficient, diversified company he turned his attention to cutting costs. He reasoned that employees would work harder if they knew it would result directly in a raise. Therefore, he set up a bonus system for productive laborers, foremen, and managers throughout the company. As Schwab described it, "Do so much and you get so much; do more and you get more—that is the essence of the system." At U.S. Steel, by contrast, Gary tied bonuses to the overall profitability of the company, not to individual performance. Under that system, Schwab noted, a worker could toil hard and creatively, but receive no reward.

Improvements in Structural Steel

Schwab's biggest move at Bethlehem was his challenge to U.S. Steel in the making of structural steel. Here he focused on an innovation in making the steel beams that went into bridges and skyscrapers. Schwab had been listening to Edward Grey, who had the idea of making steel beams directly from an ingot, as a single section, instead of riveting smaller beams together. Grey claimed that his invention provided "the greatest possible strength with the least dead weight and at the lowest cost."

The other steelmakers rejected Grey's theory; but Schwab was eager to try it even though it would cost $5 million to design the plant, build the mill, and pay Grey's royalties. The problem was that the experts were so skeptical that Schwab had trouble raising money. In fact he almost backed out, but then jumped back in with the statement: "If we are going bust, we will go bust big." He staked his own money, and that of his company, on the Grey

beam, but still he needed more. So Schwab buttonholed wealthy investors for large personal loans and then, through remarkable salesmanship, persuaded his major suppliers, the Lehigh Valley and the Reading Railroads, to give him credit on deliveries of the new steel. Schwab then aggressively recruited big contracts for the "Bethlehem beam": the Chase National Bank and the Metropolitan Life Insurance Company in New York were among them. The experiment worked. This cheaper and more durable beam quickly became Schwab's greatest innovation and he captured a large share of the structural steel market from U.S. Steel.

Schwab's actions had consequences for the American steel industry. From 1905 to 1920, Bethlehem Steel's labor force doubled every five years. By contrast, U.S. Steel often stagnated; one officer noted after Schwab left that "works standing idle have deteriorated . . . the men are disheartened and a certain amount of apathy exists." By the 1920s, the chagrined leaders at U.S. Steel secretly began making Bethlehem beams; as an official there observed, "The tonnage lost on account of competition with Bethlehem . . . is . . . ever increasing . . . we are obliged to sell at unusually low prices in order to compete." Schwab discovered their ploy, however, and forced U.S. Steel to pay him royalties.

Schwab had transformed Bethlehem Steel. Even before World War I his company had become the second largest steelmaker in America. The *New York Times* praised Bethlehem Steel as "possibly the most efficient, profitable self-contained steel plant in the country." By 1920, it employed 20,000 people in the Lehigh Valley and was among the largest enterprises in the world. In 1922, it absorbed Lackawanna Steel, the company that launched America's rail-making industry 75 years earlier.

During World War I, Schwab's abilities were needed by the U.S. government. In April 1918, one year after America entered the war, victory was uncertain. Delays in shipping cargo and troops from America to Europe threatened the Allies with defeat. More ships were needed; but in the U.S. shipyards few ships were forthcoming. Within the Wilson administration some blamed the owners of the shipyards, others blamed the workers, still others blamed radical unions. In the midst of this finger-pointing, Franklin K. Lane, the Secretary of Commerce, posed a solution: "The President ought to send for Schwab and hand him a treasury warrant for a billion dollars and set him to work building ships, with no government inspectors or supervisors or accountants or auditors or other red tape to bother him. Let the President just put it up to Schwab's patriotism and put Schwab on his honor. Nothing more is needed. Schwab will do the job."

The Schwab Formula

That month Schwab became Director-General of the Emergency Fleet Corporation for the U.S. government. In his investigation, he discovered cases of laziness, incompetence, work slowdowns, and poor coordination of the ship building. As usual, though, Schwab said, "The best place to succeed is where you are with what you have." He quickly rearranged incentives: he eliminated the "cost-plus" system whereby shipyards were paid whatever it cost them to build ships plus a percentage of that as a profit. Instead, Schwab tied profits to cost-cutting by paying a set price per ship. Cost overruns would be paid by the shipbuilders who would have to be efficient to make a profit. As usual, bonuses were part of the Schwab formula. He paid them, sometimes out of his own pocket, to shipbuilders who exceeded production goals.

Schwab enjoyed being a showman, so he went to the shipyards himself: he rallied the workers, praised the owners, and even drew applause in a speech to the Industrial Workers of the World, a radical union. Never one to ignore symbols for achievement, Schwab had Rear Admiral F. F. Fletcher head a group to award flags and medals to plants and workers whose work had been outstanding. By the fall of 1918, ships were being completed on time and even ahead of schedule. President Wilson and the leaders of the Shipping Board were astonished with the change and gave Schwab the credit. Carnegie, in the last year of his life, called it "a record of accomplishment such as has never been equaled."

Not all of Schwab's dealings with the federal government were so productive. The armor-

plate business is an example of this. The making of military equipment—armor plate for ships, gun forgings, ordnance, and shrapnel—brought Schwab into regular contact with government purchasers. Throughout his career, Schwab had problems with these government contracts. Even at Carnegie Steel, Schwab had quarreled with government officials over allegedly defective armor plate; the issue never was amicably settled.

The problem began in the 1880s when various officials began urging the United States to build a large navy. At the time the American steel companies were mostly making rails, so President Cleveland and others began urging the companies to diversify. Making military equipment was complicated and expensive, however; only reluctantly did Bethlehem Iron and Carnegie Steel shift into ordnance. Had the government not promised them Navy contracts they would not have switched.

Four things in the military supply business made for tension between the federal government and the steel companies. First, the federal government was the largest and sometimes the only buyer of military equipment; and the government's notions of quality sometimes differed from that of the producers. Often both sides had legitimate points of view. Second, since the demand for military equipment was limited and the costs of building a factory to produce it were high, only U.S. Steel, Bethlehem Steel, and later Midvale Steel made armor plate. The potential for either a monopoly or for price-rigging bothered some government officials. Third, a ton of military equipment was more expensive to make than a ton of rails or a ton of structural steel; some purchasers thought that $450 for a ton of armor plate was price-gouging if rails sold for only $25 per ton. Finally, the ordnance producers sometimes made lower bids on foreign contracts than they did on domestic ones. To some in the American government, this was evidence they were being overcharged; to the steel companies, lower bids meant they had to cut their profit margins to almost zero to overcome tariffs in foreign countries. Also, when American needs were low, the steel men argued they had to get foreign business to keep their factories operating.

The government's solution to these four problems was to threaten to go into the military supply business and build an armor-plate factory with Federal funds. Schwab countered that the government would not be able to make armor plate cheaper than he could. After all, Bethlehem had a veteran work force, a good bonus system, and could buy materials more cheaply in bulk. Any vertically integrated company would have an advantage over companies purchasing supplies in the open market. A government factory, Schwab insisted, would waste the taxpayers' money.

Misdirected Incentives

If Schwab had been a mediator, not a participant, he might have been able to settle this dispute. Part of the problem was the same as that of the low productivity of the American shipyards during World War I: misdirected incentives. When the navy took bids for contracts from the three steel companies, it naturally accepted the lowest bid. But then Navy officials went to the two higher bidders and offered them part of the contract if they would agree to accept the lowest bid. They did this so that all three producers could survive; that way, a future monopoly of ordnance would be prevented. The problem was that this strategy gave the three companies an incentive to collude and fix prices high. Why should they bid low if all of them would get part of the contract anyway? A winner-take-all approach would have provided an incentive for lower bidding, but the Navy was unwilling to do this. Not surprisingly, then, year after year the steel companies submitted nearly identical bids for military equipment.

This problem reached a crisis during the Wilson administration. In 1913, Josephus Daniels, Wilson's Secretary of the Navy, and Ben Tillman, Senator from South Carolina, investigated the armor business. Both men urged Wilson to back a government armor plant. They held hearings in Congress on the armor business but did not like what they heard. The leaders of the three steel companies all said their bids were reasonable. In fact, Schwab submitted figures showing that he and the others charged less for armor plate than did Eng-

land, France, Germany, and Japan. If others didn't believe it, then let the Federal Trade Commission look at the accounts and fix a price. Daniels and Tillman rejected this. They were convinced that the government could make armor plate cheaper: the head of the Bureau of Ordnance estimated that $10.3 million would build an armor plant and that plate could be made for less than $300 per ton, instead of $454 per ton, which was a typical bid from the steel companies.

In 1916, then, Daniels and Tillman began the campaign to convince Congress to spend $11 million for an armor factory. In the Senate, Tillman argued that the government would save money and no longer would be at the mercy of identical bids from the "greedy and hoggish" steel companies. President Wilson backed Tillman and said, "I remember very well my promise to help all I could with the bill for the construction of an armor plant and I stand ready to redeem my promise."

Schwab led the effort to defeat the bill. He spoke out against it in public and ran ads in over 3,000 newspapers challenging the need for a government plant. He stressed the fairness angle. He said that years ago the government had asked Bethlehem to make armor; they had done so only when the government agreed to buy from them. Now, with $7 million invested in equipment, the government was planning to build its own plant and make Bethlehem's useless.

Most Congressmen, however, bought the arguments of Tillman and Daniels. The bill passed the Senate and the House by about two-to-one margins, and Wilson signed it. As Senator Albert Cummins of Iowa said, "It is [one of] my profoundest convictions that the manufacture of armor-plate for battleships is a government function. I hope the private enterprises will be entirely eliminated."

Dozens of cities lobbied to be the site for the new plant. From Rome, Georgia, to Kalamazoo, Michigan, city after city was put forth as being uniquely situated to produce armor plate. The winner of this competition was South Charleston, West Virginia. Congress soon raised the appropriation to $17.5 million and authorized the South Charleston plant to make guns and projectiles, as well as armor. Construction began in 1917 on the new factory and on hundreds of houses for the workers. The war delayed the building, but it was continued later. Higher construction costs after the war meant an overrun of several million dollars. By 1921, the new plant was making guns, projectiles, and armor—all at prices apparently much higher than that of Bethlehem Steel. Within a year the whole plant was shut down, put on "inoperative status," and never run again.

Looking Backward

Schwab turned 60 in 1921 and was beginning to look backward more than forward. There was much to see: whether he had made rails, beams, or armor plate, he had been successful. Even Carnegie, near death, had written Schwab, "I have never doubted your ability to triumph in anything you undertook. I cannot help feeling proud of you for having far outstripped any of my 'boys.' "

In the 1920s and 1930s, however, Schwab seemed to lose his entrepreneurial spirit. Producing a better product at a lower price no longer seemed to dominate his thinking. Let's "live and let live" Schwab told the steelmakers at the American Iron and Steel Institute in 1927. Next year, he urged them to fix prices and avoid cutting them. The year after this, Schwab, the father of the Bethlehem beam, urged the steel men not to expand but to use their existing plant capacity.

When the Great Depression took hold in the 1930s, Schwab's public addresses were full of anecdotes and preaching that "the good . . . lies ahead." One of Schwab's remedies for the ailing economy was a high protective tariff. He had always favored a tariff on imported steel but usually settled for low duties. The Smoot-Hawley Tariff of 1930 created the highest duties in American history on many items. Some writers have argued that the Smoot-Hawley Tariff triggered the Great Depression; others say it merely made the depression worse. One thing is certain: many nations retaliated against high American tariffs by closing their borders to American-made goods. The demand for American goods, therefore, declined and this put more people out of work. When Cordell Hull, Roosevelt's Secretary of State,

tried to lower American tariffs in 1934, Schwab opposed it. He was afraid of foreign competition.

During the 1930s, Schwab enjoyed his role as elder statesman of the steel industry. He was full of stories and ever ready to do interviews with reporters. He never became senile; his ability to memorize speeches and his knack for remembering names and faces was still amazing. He just preferred to let Eugene Grace and others run Bethlehem Steel, while he worked the crowd.

When Schwab retired as an entrepreneur, his fortune became jeopardized. He had earlier shown the traits of a dissipater and still had the potential to run through his $25 million fortune. Liberated from work, Schwab traveled, gambled, and flirted more than ever. He joined the New York Whist Club and played there for high stakes. He frequented the roulette tables in Monte Carlo with his favorite mistress. The art of speculation, an anathema to Carnegie, appealed to Schwab: he installed a ticker tape in his mansion to keep tabs on Wall Street; he also invested in a variety of companies and knew almost nothing about some of them. Gambling wasn't the only drain on Schwab's wealth: he co-signed one million dollars worth of notes—usually worthless—for "friends" and also gave monthly allowances to 27 people.

Schwab refused to cut back on expenses, even during the Great Depression. He still hired the most famous musicians of the era to give private recitals for him at Riverside. The mansion itself—complete with swimming pool, wine cellar, gymnasium, bowling alley, six elevators, and 90 bedrooms—needed 20 servants to keep it functioning. He also hired 300 men to care for his 1000-acre estate at Loretto. So Schwab desperately needed his $250,000 annual salary from Bethlehem, given for past services, just to pay his expenses.

From 1935 to 1938, a small group of rebel stockholders attended the company's annual meetings; they challenged Schwab's salary and told him he had "outlived his usefulness." He finally stopped them by privately telling one of the critics that he desperately needed the money to live on. Actually he needed more. He couldn't pay the taxes on Riverside and couldn't sell it either, even at a $6 million loss. He couldn't even give it away, when he offered it as the residence for the mayor.

Schwab's last years were also marked by poor health and the death of his wife. After her funeral, Riverside was taken by creditors; Schwab moved into a small apartment. Schwab, who had shown the world a vision of entrepreneurship, now had only a vision of death. "A man knows when he doesn't want to be alive," he said, "when the will to continue living has gone from him." Schwab died nine months after he said this, at age 77, with debts exceeding assets by over $300,000. □

For full footnote citations on quoted materials and other sources, see *Entrepreneurs vs. The State*. Readers are especially directed to Robert Hessen's excellent study, *Steel Titan: The Life of Charles M. Schwab* (New York: Oxford University Press, 1975).

Self-Service

IDEAS ON LIBERTY

If it be selfishness to work on the job one likes, because one likes it and for no other end, let us accept the odium. I had rather live forever in a company of Don Quixotes, than among a set of angels professing to be solely moved to the betterment of one another. A community of creatures engaged primarily in serving one another, except for the joy of meddling in one another's business, appears, to me at least, so dreary and so empty, that I would have no part or parcel in their pallid enterprises.

—JUSTICE LEARNED HAND
The Spirit of Liberty

What Should We Do About Luck?

by James L. Payne

What should we do about the fact that some people are able to earn more money than others? Should government redress the resulting disparities in income? The answer is often believed to hinge upon our conclusion about the role of luck in affecting income-earning abilities.

Those on the political left emphasize factors beyond the individual's control. They point to accidental circumstances affecting incomes: where you were born, who your parents are, your class, or race, or culture, the education you receive, the economic possibilities in your society.

Accepting the view that the ability to earn income is largely a matter of luck, the left supports programs of income redistribution to compensate for these differences. Wealth is to be taken from the (lucky) wealthy and given to the (unlucky) poor. In this way, they say, we are correcting for inequities of nature and culture and producing a "fair" result.

Those on the right have tended to object to this policy on the ground that it really isn't luck that makes the difference. Often citing themselves as examples, they point out that wealth is the result of hard work and self-sacrifice. People are poor, they say, not because they had bad breaks but because they are lazy.

This view is a popular one in an American culture that extolls the "self-made millionaire," the Horatio Alger boy who lifts himself "by his own bootstraps." In this tradition we

applaud W. E. Henley's famous stanza (from "Invictus"):

> It matters not how strait the gate,
> How charged with punishments the scroll,
> I am the master of my fate:
> I am the captain of my soul.

Who is right? What should we do about luck?

In overall, cosmic terms, it seems difficult to refute the left's position. All that we are, each molecule within us, comes from beyond ourselves. If one prefers the religious formulation, we must ultimately trace our abilities and successes to the endowments of an omnipotent God. One can even argue that willpower itself is part of the biological makeup: some people just have a higher energy level or more determination than others.

On social grounds as well, those emphasizing the importance of luck would seem to have the sounder position. The arrogance of the "self-made man" is corrosive. His bragging about his "own" success provokes resentment, and his conviction that the poor are to blame for their plight makes him uncharitable. It is much nicer to live in a society where people accept

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the traditional Christian orientation, that God gives us everything, "ourselves, our time, and our possessions"—as it is put in the *Lutheran Book of Worship*. Believing this, people are more disposed to help their neighbors in times of trouble.

It is healthy, therefore, to acknowledge the enormous role played by luck in personal success. But it does not follow that this perspective should be the foundation of government policy. This is where the left goes wrong.

The first problem with using the state to redress the effects of luck is ethical: it is not moral to use force against someone in retaliation for his good fortune. The point is easily overlooked because we often forget that government action is grounded upon coercion. It is further obscured because taxation generally involves policy aims in addition to income redistribution.

To see the point clearly, let us imagine the operation of a pure system of redistributive taxation. Government agents say that John must pay, let us say, $5000 *because* he earned an above-average income. John disagrees and resists, the agents bring force to bear, and John winds up being fined or thrown in jail. Hence John has been *punished* for an action—earning more money than another—which should not be considered a crime. In fact, his behavior is commendable, for the work he has done to earn his high income is socially useful.

We can still maintain that John has a responsibility toward those less fortunate than himself, but we should advance this position through persuasion, seeking its implementation through voluntary means, not state coercion.

The second objection to state redistribution of wealth to correct for the effects of luck is economic. Individuals may not be responsible for their talents and abilities, but they are *motivated* beings. They respond to the rewards and penalties which confront them. It is in this sense that a rich person might feel "self-made." He knows that his wealth came as the result of hard work and sacrifice, not by sitting under a tree. When we pursue a particular payoff and achieve it, we feel proud of our effort. We feel that the reward—a pay check, let us say—did not come through some kind of "accident" or "luck." We know that we worked!

Because we are motivated organisms, policy-makers have to be careful how they manipulate the pattern of rewards. Unfortunately, left-wingers are rather insensitive to this issue. They tend to assume that people will go on doing good and constructive things in spite of governmental policies that weaken the relevant incentives. Working, in particular, is thought to be automatic: teachers will teach and welders will weld regardless what we do to the incentive systems which support these activities.

But of course this view is naive. Work and productivity in work are extremely sensitive to reward systems. This is why state redistribution policies are so harmful: they undermine incentives for both the lucky and the unlucky. The more productive members of society are discouraged from being as productive as they could be by denying them some of the fruits of their labor, as is clearly done in an income tax. And the less productive are discouraged from working since they are supported by unworked-for income.

Voluntary charity as a method to compensate for luck largely avoids the drawbacks of state systems. For the donors, voluntary charity does not discourage work but becomes a reason *to* work. Charitable giving is a consumption item that the donor freely spends his money on, like buying a stereo or tickets to the opera.

For the recipients, the main problem with state charity is its routine, perpetual character. This feature seems inevitable when government is involved, since the distribution of money must be tied to firmly established regulations in order to be (or seem) fair and accountable to the entire nation. The regularity of state monies maximizes their disincentive effect: the recipients can become dependent upon them.

Private charity, especially individual charity, is much more flexible and, from the recipient's point of view, undependable. It can thus be the "helping hand" in an emergency without becoming a permanent part of the beneficiary's work and income calculations.

The Biblical injunction to accept ourselves humbly as creatures of God, not as self-made men, is healthy. And so is the exhortation to help those less fortunate than ourselves. The error lies in using the state in an attempt to implement these ideas. □

Origins of the Chinese Hyperinflation

by Jay Habegger

Between 1935 and 1949, China experienced a hyperinflation in which prices rose by more than a thousandfold.[1] The immediate cause of the inflation is easy to isolate: the Nationalist government continually injected large amounts of paper currency into the Chinese economy. The monetary expansion was so severe that during World War II, Nationalist printing presses were unable to keep up, and Chinese currency printed in England had to be flown in over the Himalayas.[2]

A prerequisite for any sustained inflation, however, is monopoly control of the money supply. In the absence of a monopoly, individuals simply will switch to a competing currency when one becomes inflated. Thus, a key question in the study of any inflation is how the state obtained monopoly control.

In the case of the Chinese inflation, this question has been largely overlooked. Most authors who have chronicled the inflation have focused on events which occurred after the Nationalists managed to obtain control of the currency. Let us thus examine how the Nationalist government gained monopoly power over the Chinese currency.

Prior to 1935, China enjoyed a limited free banking system. Privately owned banks operated thoughout China, although the largest Chinese banks and all the foreign-owned banks were based in Shanghai. Some provincial governments controlled their own banks, but they had to maintain the same standards as private banks in order to compete.

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Privately held banks operated like any other Chinese business and competed with one another to obtain customers. Most banks issued their own notes which were redeemable in silver, the traditional medium of exchange in China. The notes from each bank circulated freely with the notes from other banks. Perhaps most noteworthy is that Chinese banks operated largely without state regulation. A free banking system has inherent checks against inflation—primarily because customers will flee from depreciating currencies—and instances of banks' inflating their currencies were extremely rare.[3]

The arrival of the Nationalist government in 1927 started a long process to eliminate free banking in China. By 1935, the Nationalists had succeeded. Rather than outright seizure, they followed an incremental approach to gain control of the currency. The first steps were aimed at insuring the political and financial support of the largest Chinese banks. Eventually, the banks would become dependent on the government. The final step was to bring Chinese banks under direct control of the Nationalists, removing all barriers to currency control.

In 1927, the process began when banks got caught in the political split between the Nationalists and the Communists. Violent strikes led by Communist labor leaders crippled industry in Shanghai. When the bankers appealed to the Nationalist Party to stop the strikes, Chiang Kai-shek saw an opportunity to bolster the financial position of his new government. He struck a deal with the bankers which stipulated that Chiang would suppress the strikes, in return for loans to the Nationalist government.

Believing that a Nationalist victory would be more favorable to their businesses than a Communist success, and anxious to protect their loans to the Nationalists, the banks became a quick source of funds for the Nationalist government, as well as staunch supporters, even while their freedom to operate was being eroded.

Eventually the bankers became leery of lending more funds to the Nationalists. The government appeared to be a financial black hole, and the bankers were skeptical of its ability to service its debts. When the bankers refused to extend more loans to the Nationalists, Chiang used the same methods against the bankers that he had used against the strikers. A banker who wouldn't supply more loans might be thrown in jail as a political subversive or have his property confiscated.

Reliance on Deficit Financing

The reason the Nationalists needed bank loans was their heavy reliance on deficit financing. Widespread taxation was politically unattractive as well as an administrative nightmare. Under these circumstances, Chiang saw deficit spending as the most expedient method to finance his government. For example, in 1927, the first year of the Nationalist regime, loans accounted for 49 per cent of government revenue.[4] And the government continued to increase its debt without any way of servicing it.

To prevent the bankers from becoming politically disaffected and to maintain long-term financial support, Chiang's Finance Minister and brother-in-law, T. V. Soong, promoted a policy of "cooperation" with the bankers. Soong's aim was to further tie the bankers to the fate of the Nationalist government.

In the spring of 1928, Soong began to put his plan into action. He arranged for the Nationalist government to offer large quantities of securities. To insure purchase, the securities carried high interest rates and were sold at substantial discounts from their face values. For example, the government sold securities in 1931 at little more than 50 per cent of their face values.[5] Thus, the Nationalists postponed their financial problems until the bonds came due.

The bankers were aware of the potential problems with the bonds, so to make them even more salable, the securities were guaranteed. Each issue was backed by a government revenue, such as customs taxes or salt taxes. Because of the incentives, the rate of return on government securities was far greater than anything the bankers could have obtained on similar investments in private concerns.

Soong also set out to develop a system of public finance patterned after Western nations. In 1928 he founded a central bank, the "State Bank of the Republic of China," although he hadn't as yet been able to establish a government monopoly over the issuance of notes.[6]

At the outset the bank was primarily an extension of the Nationalist Treasury, although it did issue its own notes. While the Central Bank primarily handled the revenue of the Nationalist government, it also competed with private banks for business. The revenues of the bank were used to purchase government bonds. To enhance the bank's image and further tie other private banks to the Nationalist government, Soong appointed many of the directors of private banks to the board of directors of the Central Bank, although the board actually held little power.

The market for government bonds was supported by the Chinese banks. By 1932, Chinese banks located in Shanghai held between 50 per cent and 80 per cent of outstanding government bonds.[7] As intended, the banks were financially bound to the Nationalist government. Government activities had a large effect on the values of banks' assets, so that the relationship between the Nationalists and the banks grew even closer. Commonly, Nationalist officials who controlled the issuance of government bonds would sit on the boards of private banks. Having inside information, many government officials became extremely wealthy trading in government securities.[8]

The financial events following the Japanese invasion of the Chinese mainland in January 1932 illustrate just how closely the banks were tied to the Nationalist government. When the Japanese force landed, a panic spread through the bond market and a rush developed to unload government securities. Within five days of the invasion the average price of government bonds

dropped to less than 60 per cent of face value, which represented a severe loss for banks holding a large amount of bonds.[9] Fearing that the notes of some banks soon would become irredeemable, panic spread and there were "runs" on some banks; at least two Chinese banks failed due to the crisis.[10]

While the Nationalists tried to end the autonomy of the banks by binding them to the government, the final blow to Chinese private banking came from the United States. Beginning in 1933, the U.S. began to purchase large amounts of silver, and in June 1934 the Silver Purchase Act was passed. This Act instructed the United States Treasury to purchase silver until the world price of silver rose above $1.29 per ounce, or until the monetary value of the U.S. silver stock reached one-third the monetary value of the gold stock.[11]

Although the Silver Purchase Act was intended primarily as a commodity support program for silver producers in the United States, it had an enormous effect in China. As a result of the U.S. legislation, the world price of silver jumped rapidly, and from early 1933 to the end of the year the price of silver rose by 75 per cent; by the middle of 1935 the price had tripled.[12] Since almost every bank note in China was backed largely by silver, the U.S. silver buying program triggered a sharp deflation in China. The appreciated silver caused exports to shrink while imports rose, which produced a net outflow of silver. The banks sold their silver abroad, withdrew notes from circulation, and slowed the rate of new note issue.

The declining supply of bank notes caused each note left in circulation to appreciate in value, leading many businesses to experience accounting losses. With prices falling, selling prices often could not meet the previous costs of inputs. The losses caused many businesses to lay off workers and cut production.

Also, many businesses carried some debt. The loans were made in non-deflated currency, but now had to be paid back in deflated money. The real value of the debt ballooned while the businesses had less cash flow to service it. Unable to foresee the actions of the U.S. Congress, businessmen had assumed debt which appeared to be a prudent risk. Now they had more debt than they had bargained for. Of course, the Nationalists also were feeling the adverse effects of the deflation. Their policy of debt financing suddenly became an even greater burden.


BETTMANN ARCHIVE

Chiang Kai-shek at time of attempt to organize war against Japan, c.1936.

In an effort to stop the deflation, the Nationalist government imposed export controls on silver. The export controls proved unsuccessful, and the smuggling of silver became an occupation in itself. Much silver was smuggled through foreign-owned banks, since they were immune from Chinese regulations.

The desperate financial situation wrought by the deflation prompted the Nationalist government to seek new revenue sources. It granted the Central Bank special privileges, such as exemption from silver export controls, so that the Central Bank was able to earn large revenues while private banks were struggling. Because of government patronage, the Central Bank became the most profitable financial institution in China. Although it held only 11 per cent of the assets of all Chinese-owned banks, it earned 37 per cent of all banking profits in 1934.[13] Most

of the Central Bank's profits were used to finance the Nationalist regime.

Despite export controls and the revenues of the Central Bank, throughout 1934 the financial situation of the Nationalist government became increasingly worse. In an attempt to sell more government securities, the Nationalists issued the Savings Bank Law. This legislation required each savings bank to purchase government bonds until its holdings of such bonds represented one-fourth of total deposits. But even the Savings Bank Law failed to have a significant effect on the Nationalists' financial position.

Perhaps because of the government's financial situation, the largest private bank, the Bank of China, attempted to loosen its ties to the Nationalists. The Bank of China began liquidating its holdings of government bonds at a loss. Since many smaller banks tended to follow the Bank of China, the Nationalists were worried that large-scale liquidation of government bonds would follow. If the bond market collapsed, the Nationalists would be unable to continue the policy of debt financing. In desperation, the government began to look for another solution to its financial problems.

Rather than cut expenditures, the new finance minister, H. H. Kung, in consultation with Chiang Kai-shek, devised a scheme to harness the resources of the largest banks to further underwrite the Nationalist government. Instead of making the securities themselves more attractive, Kung intended to seize outright control of the two largest private banks in China, the Bank of China and the Bank of Communications.

The first step was to initiate a propaganda campaign against the bankers, essentially blaming them for China's economic problems. Kung asserted that business failures, caused by the deflation, were a result of the banks' placing their own profits above the public interest. The propaganda worked. Irate citizens voiced opposition to the banks, and Chinese newspapers ran editorials supporting Kung's charges.

Public opinion and Kung's urging persuaded the banks to establish a fund from which emergency loans would be made to ailing businesses. But Kung's concern for failing businesses was largely a front. His primary concern was the financial condition of his employer, the Nationalist government. The propaganda campaign was designed to sway public opinion in favor of government seizure of the Bank of China and the Bank of Communications.

On March 23, 1935, Kung announced that the Nationalist government would seize control of the two banks. Kung gave the takeover the appearance of legality by arbitrarily creating enough shares in each bank for the government to become the majority stockholder. Instead of using the emergency fund to aid businesses, it was used to partially pay for the shares of the banks. The rest was financed with a nominally equivalent value of government securities. Kung removed the old bank officials and replaced them with government appointees.

In June 1935, the Nationalist government used resources from the two banks to gain control of some of the smaller private banks. Kung ordered the three government banks—the Bank of China, the Bank of Communications, and the Central Bank of China—to hoard the notes of several smaller banks in Shanghai. When they had amassed a substantial quantity of the notes of the smaller banks, the three government banks simultaneously presented them for redemption. Since the banks were unable to redeem all the notes at once, Kung declared the banks to be insolvent and immediately seized control. He insisted that the government would manage them in the public interest. Again, the officials of the banks were removed and replaced with political appointees.

The End of Private Banking

By July 1935, the Nationalist government had ended private banking in China. The resources of the Chinese banks were at the Nationalists' disposal, since they held a majority interest in each bank. No time was wasted in using these resources to finance the government. The banks were directed to purchase government securities and to advance loans. But even with the resources of China's largest banks, the Nationalist government was barely able to remain solvent.

The banking coup had no effect on the deflation. Businesses continued to fail as more silver

was smuggled out of China. In a futile attempt to stop the deflation, the Nationalists made the smuggling of silver out of China a crime punishable by death or life imprisonment.[14] Still, the deflation continued.

With the end of private banking, Kung proposed to institute a managed currency backed by nothing more than government promises. The switch to a paper currency was intended to benefit the government in two ways. First, all silver in China would come under the government's direct control. With government control of silver and the help of a "Currency Stabilization Fund" created by the United States and Great Britain, it was believed that the deflation could be stopped. Second, the government would have monopoly power over the money supply, so that it would be possible to monetize the government debt.

On November 3, 1935, the Nationalist government issued the Currency Decree.[15] Effective the next day, only notes issued by the three largest government banks—the Bank of China, the Bank of Communications, and the Central Bank of China—were to be legal tender in China. The new currency, called the *fai-pai* or Chinese National Currency, was to be managed by the Central Bank of China. The notes of private banks were allowed to continue circulating in fixed amounts, although they were to be gradually phased out. All institutions and individuals who owned silver were ordered to exchange it for the new currency within six months.[16]

To preserve confidence in the new currency, the Decree contained provisions to establish a "Currency Stabilization Fund." The Fund was to buy and sell foreign exchange in order to keep the exchange rate of the Chinese currency approximately constant relative to certain foreign currencies. The Decree also contained provisions to alter the function of the Central Bank. Instead of merely being an arm of the Nationalist Treasury, the Central Bank was to become a "banker's bank" distinct from the Nationalist Treasury.[17] Also, the Decree maintained that "plans of financial readjustment have been made whereby the National Budget will be balanced."[18] And, according to Finance Minister Kung, "The government is determined to avoid inflation. . . ."[19]

The wording of the Decree was the government's attempt to quell fears of inflation. Chinese newspapers ran editorials assuring the public that the Nationalists had nothing but the best intentions for the Chinese economy, and the move to a paper currency was heralded by economists around the world as a step toward a modern banking system. But, despite the provisions of the Decree, the Central Bank was never removed from the Treasury's control. Even more fraudulent was the assurance that the budget would be balanced. Indeed, the government deficit increased in the years following the currency reform.

In retrospect, Kung's statement seems like a cruel joke on the Chinese people. The currency reform destroyed the private banking system which had served the Chinese economy well, and placed control of the currency in the hands of a corrupt and inept government. Inflation began almost immediately. Eventually the inflation became so severe that it helped bring about the collapse of the Nationalist regime. Thus, monopoly power over the currency proved fatal to the Chinese economy, since the inflation that Kung was "determined to avoid" occurred with a severity and length unparalleled in history. □

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The International Debt Crisis

by Ken S. Ewert

Once there was a man with a large sum of money. He decided to lend a considerable portion of it to a man from a faraway country who offered him a high rate of return. But the foreigner wasted some of the money in riotous living, he was careless and allowed some of the money to be stolen, and what he did invest soon soured because of his poor investment skills. It wasn't long before he had trouble making the payments on his debt. The lender saw the debtor's poor stewardship, but not wanting to admit his own mistake in lending to the man, lent him still more money in the hopes that the debtor would begin to prosper. But the debtor continued his thriftless ways, and the lender soon found himself in serious financial trouble.

This simple story describes, by analogy, what economists call the "world debt crisis." In our parable, the lender symbolizes the several large commercial banks (American, Japanese, and European) which made substantial international loans during the 1970s and early 1980s, and the debtor represents countries such as Brazil, Mexico, and other less developed countries (LDCs) which borrowed heavily during that period. Most people understand this story as far as it goes—how the international debt problem happened. But most of us are still in the dark as to why it happened, and how this crisis is likely to be resolved.

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What Caused the Massive Debt?

By 1982 the LDCs owed over $500 billion to Western banks, governments, and international agencies. This amounted to a fivefold increase in their indebtedness during the previous decade.[1] Clearly there had been a world-wide splurge of credit. But why? Was it because of greedy bankers? Were avaricious LDC governments to blame? Both the banks in their reckless chase after profits, and the borrowing countries in their ill-advised pursuit of wealth and power, bear responsibility for the present crisis. But greed alone does not adequately explain why so many people made the same sort of error at the same time. Why did the explosion in international debt occur in the 1970s rather than the 1960s or the 1950s? Was there a reason which caused the lenders to extend credit and the debtors to accrue debt on such a grand scale?

The explanation often given for the huge loans made to LDCs during the mid and late 1970s is that the banks were recycling "petrodollars." This explanation goes as follows: In 1973 the OPEC cartel succeeded in exacting huge increases in the price paid for their oil and found themselves suddenly rich in dollars. These dollars needed to be invested, and many of them were deposited with the "money center" banks in London and New York. These banks, suddenly rich in deposits, turned around

and invested these funds in the form of loans to the LDCs. The process was repeated in the late 1970s when OPEC again was able to increase sharply the price of oil. It was this inflow of petrodollars which gave rise to spurts of extraordinary lending in the mid 1970s and again in the latter part of the decade.

This explanation has some truth to it, but it fails to address an important issue. Why did OPEC, an obscure cartel which had been in existence for more than a decade, suddenly, in the early 1970s, find itself in a position to demand four times as many dollars as before for its product? One obvious reason for the cartel's success is that the dollars which the oil producers sought to "buy" with their oil had become more plentiful. But where did these dollars—which eventually became loans to the LDC debtor countries—come from in the first place?

Dollars are created by only one entity—the Federal Reserve System (the Fed). The inflation—the increase in the quantity of money and credit—of the late 1960s forced the Nixon administration to cut the tie between gold and the dollar in 1971. Too many dollars had been created, and the U.S. Treasury no longer had sufficient gold to redeem dollars at their declared value. With the Fed completely freed from the constraints of gold, the rest of the decade of the 1970s, on the whole, was even more inflationary. Between 1970 and 1984, the Eurodollar market (U.S. dollar deposits held in foreign countries) grew from $100 billion to nearly $2 trillion.[2]

It was this monetary expansion which precipitated the massive amount of international lending that took place in the 1970s. Banks found themselves flush with new deposits (including OPEC's petrodollars) and the money had to be invested somewhere. From the vantage point of many bankers, the developing countries seemed an excellent place to invest.

Why Loans to LDCs?

Why did the banks lend to governments and businesses in developing countries?[3] One obvious reason was the economy of scale inherent in these loans. It was much easier and potentially more profitable to make a single $100 million loan to the Mexican government as opposed to hundreds of separate loans to American developers, businesses, or homeowners. Rather than having to investigate a multitude of individual projects, a loan to the LDC meant that the LDC's government investigated (supposedly) and administered the funds to the assorted state and private borrowers. The loans also were alluring because of the guarantee (either implicit or explicit) of the LDC governments. Surely a sovereign government—always having the power to tax—would not go bankrupt.

Another attraction of these loans was the high yield which they offered. Many loans were negotiated for floating interest rates, often at rates of one-and-a-half to two per cent above LIBOR (the London Interbank Offered Rate). The fact that these loans had floating rates considerably lessened the risk of future inflation's wiping out the real value of the banks' loan assets. In contrast, domestic loans during the same period usually were negotiated at fixed rates, and were subject to interest rate ceilings and offered substantially lower rates of return.

Reasons for Borrowing

Why were the developing countries so eager to borrow? One important factor was the economic philosophy which had gained prevalence in these nations. Western "development economists" had been influential in shaping economic thought in these countries, as had the prominent Western universities which educated (directly or indirectly) many of the debtor country's most influential citizens. These development economists and prestigious universities, with few exceptions, were teaching that economic development can best be achieved through a "directed" economy. The views of Nobel Laureate Gunnar Myrdal reflect the prevailing wisdom of development economists during the 1950s and 1960s. According to Myrdal: "All special advisers to underdeveloped countries who have taken the time and trouble to acquaint themselves with the problems, no matter who they are . . . all recommend central planning as a first condition of progress."[4]

Although other development economists

were not so blunt in their advocation of centralized planing, they were essentially in agreement with Myrdal. A group of leading development experts, writing in a volume sponsored by MIT's Center for International Studies, stated that "there are limits to the effectiveness of the private market institutions, especially where development must be accelerated. It may be necessary to plan out in advance the key pieces of a general development program."[5]

Sadly, these Western counselors had rejected the very principles which were responsible for the economic success of their own nations. Private property rights and private investment, the experts advised, stood in the way of swift economic progress. Accelerated economic growth, they said, could be accomplished only through a large-scale inflow of capital, and this inflow could be best accomplished through state borrowing. This was just what LDC prime ministers and finance ministers wanted to hear, since borrowing and planning economic development would mean new power and prestige for their governments.

Another incentive to borrow heavily was the continuing depreciation of the dollar throughout the 1970s. During much of the decade, the value of the dollar depreciated at a greater rate than the rate of interest at which the LDCs could borrow. This meant that during parts of the 1970s these loans, in effect, were at negative interest rates. In this bizarre inflationary environment, borrowers, at times, actually were being paid for borrowing.[6]

In anticipation of continuing inflation, the LDC countries borrowed expecting to repay their debts with less valuable dollars. But they were wrong. The U.S. did not continue to inflate at increasing rates, and by the close of the decade the Federal Reserve, under new chairman Paul Volcker, had begun to slow the rate of monetary growth. Interest rates in 1981-82 were approximately double the level of 1978-79 rates, and the dollar no longer was depreciating so rapidly in value. By the early 1980s, many debtors were faced with economic stagnation and greatly increased interest burdens.

What had gone wrong? Where had the "development capital" gone? The truth is that a good deal of the money had not been productively invested, but was simple squandered. A significant amount was stolen by government officials. The Mexican government of Lopez Portillo was infamous for its billion-dollar frauds and the *mordidas*—bribes—which were commonly necessary to "arrange matters" with government officials.[7] And Mexico was not unique. Several LDC leaders are among the world's wealthiest people. President Suharto of Indonesia has an estimated wealth of $3 billion, President Mobuto of Zaire owns an estimated $5 billion, and former Philippine President Marcos is believed to be worth $10 billion.[8]

Consumed by the State

More often than not, the loans were used to aggrandize the state and expand its power. During the heaviest period of lending (1976-1982), the number of state-owned businesses in Mexico was doubled.[9] The borrowed wealth allowed popular subsidy and transfer programs to flourish, and the public sphere grew at the expense of private freedom. In Mexico, for example, the portion of GNP consumed by the state virtually doubled between 1970 and 1986.[10]

To be sure, some funds were invested in bona fide capital projects. Unfortunately, these projects most often represented political and not consumer priorities. In a free economy, what is produced is ultimately decided by consumers who cast their economic "votes" for particular products or services. By buying one product and not another, they communicate their preferences. Profit-seeking producers, eager to anticipate and fulfill consumers' desires, invest capital in the appropriate industries.

The foreign loans of the 1970s, however, went primarily for capital projects chosen by the state. Such grandiose projects as the construction of the Itaipu Dam between Paraguay and Brazil, and the building of roads through the Amazon jungle, undoubtedly benefited some people and boosted the governments' popularity. However, they were not the most efficient use of capital; the same funds in the hands of free-market entrepreneurs would have been put to different uses and better satisfied

the wants of consumers. Contrary to the hopes of the planners, the state investments did not generate the wealth necessary to repay the loans.

With triple-digit inflation, price controls, oppressive taxation, stifling regulations, and a basic disrespect for private property rights, many of the debtor nations have almost destroyed private enterprise. Rather than invest in their own countries, many individuals have converted their currencies into dollars and invested them in nations which are economically freer and more stable. This is called "capital flight." One study by a New York bank found that from 1978 to 1983, while Argentina incurred $35.7 billion in new loans, $21 billion left the country; the Philippines added $19.1 billion of new loans and $8.9 billion left the country; and Venezuela added $23 billion while its citizens spirited abroad $27 billion.[11]

This extraordinary capital flight indicates what the citizens of these nations think of their governments' policies. Fearful of their wealth's being consumed by taxation or destroyed by inflation, they convert it to hard currencies and invest abroad. It is ironic that while the LDC governments were borrowing in order to "dirrect" capital investment for the good of their economy, the same statist policies were driving out private capital.

Problems for Banks

When in 1982 many countries could not pay their debts, commercial banks and governmental agencies, such as the International Monetary Fund (IMF), scrambled to reschedule the loans. This involved stretching out the payment periods and decreasing the interest rates. The IMF advanced new loans to struggling debtors on the condition that the LDC governments follow certain prescribed "austerity measures." Between 1982 and 1986, billions of dollars of new short-term loans were made to enable the debtor countries to make their interest payments.[12] But this was only a band-aid solution. The banks were extending new loans not because of their confidence in the future ability of these nations to repay, but rather to avoid having loan payments declared in arrears by bank regulators. Recognizing the default of these LDC debtors would mean that many of the large banks would be "insolvent," or in more blunt terms, bankrupt.

In 1985, Treasury Secretary James Baker announced the Baker Plan to address the debt crisis. The plan called for commercial banks to extend $20 billion in new loans, and for the debtor countries to enact reforms reducing government intervention in their economies. It also called for an increase in funds and a new debt financing role for the World Bank. Under the Baker Plan, the IMF was to continue its role as the lender of last resort or "safety net" to the LDCs.

But by 1986 it was clear that the new loans and IMF rescue packages had failed to solve the debt problem. The big debtors—Brazil, Mexico, and Argentina—showed little sign of improvement, and the money-center banks with large LDC loans were facing declining credit ratings and increasing costs of borrowing from depositors. Despite arm-twisting by Federal officials, many commercial banks were becoming reluctant to make new loans.

In February 1987, Brazil, the largest international debtor, announced that it would no longer pay interest on its debt. In May of that year, Citicorp announced a record $3 billion increase in its loan-loss reserves. It was, in the words of *Business Month,* "a breathtaking public admission that the banks and the governments of the major industrial nations will never recoup the $1 trillion they are owed by developing countries."[13] Following Citicorp's leadership, several other major banks increased their loan-loss reserves in recognition of the almost certain default of a large portion of their LDC loans.

What Will Happen?

Is there any chance that more than a fraction of these loans will be repaid? One option that offers a glimmer of hope is "debt-equity swaps," in which the banks sell their loans back to the LDC country at a discount in return for local currency. The currency then is converted into equity investments in the LDC. This approach has its limitations, not the least of which is the lack of respect for private property in many of these countries (such as was exem-

plified by the nationalization of Mexican banks in 1982). Other problems include the rampant inflation and wild currency swings which make business in an LDC difficult, and the fact that most LDCs are wary of foreign investments and place strict limitations on them.[14] To date there have been only a few billion dollars worth of debt-equity swaps, hardly a dent in the three to four hundred billion dollars owed to Western banks.

There is little question that apart from a radical and sustained change in the role of government in the LDCs, the bulk of these loans will not be repaid. Most of these countries have long since stopped paying principal and many, such as Brazil and Argentina, are in virtual default. The pertinent question now is: If the debtors won't pay, who will?[15]

Recent moves by money-center banks to increase their loan-loss reserves are a significant step toward recognizing and bearing the losses. However, even Citicorp's record increase in reserves last year only amounts to a write-off of 25 per cent of its total LDC portfolio.[16] Since the "secondary markets" currently value the LDC loans at somewhere between 45 and 55 cents on the dollar, Citicorp and other banks will likely need to make more large increases in their loan-loss reserves.[17] This may mean several years of low stock prices, difficulty in raising new equity, and high costs on borrowed funds—not a pleasant scenario for bank management.[18]

But will the losses ultimately be borne by the banks and their shareholders? There are certainly those in the banking industry who are calling for government action to "socialize" the losses, or in other words to pass them on to individual citizens. Unfortunately, it seems that this call is falling on sympathetic ears among policy makers. There is no doubt that Washington fears the ramifications of one or several large banks' failing.

One way these losses are being socialized is through monetary policy. The Fed has pursued a very loose policy since late 1984, thereby devaluing the dollar and lowering interest rates. This favors the debtor nations, making it possible for them to repay their debts with less valuable dollars. Through monetary inflation, a banking crisis may well be averted as the real value of the LDC debt is inflated away. Who pays in this scheme? All the individuals and institutions who own dollars pay. Dollar holders find the purchasing power of their savings deposits or securities eroding and their standard of living reduced.

But the extraordinary monetary ease since late 1984 has failed noticeably to help the debtor countries climb out of their hole. Bound by their addiction to paternalistic governments, they have only fallen more firmly into the grasp of debt. If these countries cannot service their debts when interest rates are low and dollars are easy to come by, there truly will be a world debt crisis when, inevitably, the Fed tightens and interest rates rise in recognition of the dollar inflation.

A second way the LDC debt is being foisted on the innocent is through lending by international agencies. Since these organizations are funded by the U.S. and other industrialized countries, new loans are really a transfer of wealth from American (and German, Japanese, etc.) citizens to the commercial banks with problem foreign loans.

During the past few years, the citizens of the industrialized countries unwittingly have picked up an increasing portion of the tab for bad LDC debts. Between 1980 and 1984, transfers via the World Bank to Latin American debtors doubled from $1.6 billion to $3.2 billion, and the Inter-American Development Bank (IADB) increased its disbursements from $1.4 billion to $2.4 billion.[19] Although these amounts are still relatively small in relation to the outstanding debt, the trend is alarming. It is quite possible that in the future, U.S. and European authorities will "socialize" larger portions of the debt through international agencies such as the World Bank, the IADB, and the IMF.

While the Federal Reserve deserves considerable blame for its role in prompting the excessive lending, we must remember that some banks did lend wisely during the credit expansion. Not every bank was willing to loan more than 100 per cent of its equity capital to Latin American countries. Morally, there is no question as to who should bear the burden of these losses. The commercial banks which entered into these loans aware of the risks should face

the consequences of what turned out to be their imprudence. The many innocent individuals who had no part in such lending should not be forced to pay for the injudicious behavior of a few banks. □

1. Darrell Delamaide, *Debt Shock: The Full Story of the World Credit Crisis* (New York: Doubleday & Company, Inc., 1984), p. 7.

2. Hans F. Sennholz, *Money and Freedom* (Springs Mill, Pa.: Libertarian Press, Inc., 1985), p. 5.

3. At the September 1980 meeting of the International Monetary Fund and the World Bank, the competition to invest in LDCs was such that on some occasions "bankers were literally chasing prime ministers and finance ministers around hotel lobbies in a desperate effort to outlend their rivals." John H. Makin, *The Global Debt Crisis: America's Growing Involvement* (New York: Basic Books, Inc., 1984), p. 5.

4. Gunnar Myrdal, *An International Economy* (New York: Harper and Brothers, 1956), p. 201, quoted in Paul Craig Roberts, "Third World Debt: Legacy of Development Experts," *The Cato Journal* Vol. 7, No. 1, Spring/Summer 1987, p. 232.

5. Max F. Millikan and Donald L. Blackmer, eds., *The Emerging Nations: Their Growth and United States Policy* (Boston: Little, Brown and Co., 1961), quoted in Roberts, p. 233.

6. During the inflation of the 1970s "the interest rates at which Eastern Bloc nations and LDCs borrowed were generally below the U.S. inflation rate. As a result, the real cost of carrying external debt was negative during this period." Robert Weintraub, "International Debt Crisis and Challenge," *The Cato Journal* Vol. 4, No. 1 (Spring/Summer 1984), p. 28.

7. George Byram Lake, "Nothing Left to Steal," *National Review,* July 3, 1987, p. 40.

8. George B. N. Ayittey, "The Real Foreign Debt Problem," *The Wall Street Journal,* April 8, 1986, p. 30.

9. Lake, p. 41.

10. *The Heritage Foundation Backgrounder,* "A U.S. Strategy To Solve Mexico's Debt Crisis," July 17, 1986.

11. Ayittey, p. 30. According to one estimate involving eight highly indebted LDCs as a group, for the period of 1974-1982, for every U.S. dollar that was lent, 30 cents left the countries. Mohsin S. Khan and Nadeen Ul Haque, "Capital Flight From Developing Countries," *Finance & Development,* Vol. 24, No. 1 (March 1987), pp. 3-4.

12. Total debt for LDCs rose approximately 25 per cent between 1982 and 1986.

13. Edward Mervosh, "Unspeakable Debts, Unthinkable Answers," *Business Month,* October 1987, p. 56.

14. Of the big debtors, only Chile has fully embraced the concept of debt-equity swaps. Argentina requires investors to invest an additional dollar for every dollar of debt they swap for foreign currency. Mexico restricts foreign ownership to "non-strategic areas" such as tourism, and Brazil has prohibited foreign investment in its computer industry. Peter Truell and Charles F. McCoy, "Third World Creditors Give Debt-Equity Swaps a Try," *The Wall Street Journal,* June 11, 1987, p. 6.

15. The proposal unveiled by Mexico on December 29, 1987 has been hailed by some within the financial community as "innovative" and a "major breakthrough" in managing Mexico's debt crisis. According to this plan, Mexico will issue $10 billion of new marketable bonds which will be collateralized by a zero-coupon U.S. Treasury Bond (which will be purchased for $2 billion and will have a maturity, in 20 years, of $10 billion). Mexico will swap its newly created bonds—at a discount—for those currently held by its creditors. Under this plan, only the principal of the bond will be collateralized by the zero-coupon Treasury bond. The interest payments are not collateralized and remain backed only by the "full faith and credit" of Mexico. Also, the discount which Mexico has indicated it would like (50 per cent) would require a substantial write-down of assets for the participating banks—a larger loss than many of the banks can absorb. Many of the major U.S. lenders to Mexico have indicated they won't take part in the plan. Wendell Wilkie Gunn, "Mexico's Old Bonds in New Bottles," *The Wall Street Journal,* January 14, 1988, p. 26.

16. Mervosh, p. 56.

17. Regional banks, which have not lent so heavily in the LDC loan market, are in better shape to weather defaults. Many of the regionals have loan-loss reserves of 50 per cent of their Latin American loans. Jeff Bailey, and G. Christian Hill, "Regional Banks May Be Eager For Mexican Plan," *The Wall Street Journal,* December 31, 1987, p. 2.

18. It's obvious that in recent months bond investors have taken a grim view of the large money-center banks. Investors, in some cases, are turning the securities into "de facto junk bonds." The average yield of single-A notes issued by money-center banks has risen to a 1.5 per cent premium over Treasury issues during recent months (from less than 1 per cent). Matthew Winkler, "Some Banks' Debt Is Behaving Like Junk," *The Wall Street Journal,* February 2, 1988, p. 16.

19. Richard E. Feinberg, "Latin American Debt: Renegotiating the Adjustment Burden," *Columbia Journal of World Business,* Fall 1986, p. 23.

Resolving the Crisis

IDEAS ON LIBERTY

Policies of interventionism and socialism tend to immobilize the population and capital of the world, thus bringing about or maintaining the world divergencies of productivity, of wealth and income. A government that nationalizes efficient industries producing for the world market and then mismanages them not only hurts the interests of its own people but also those of other nations living in a world community.

These international conflicts are inherent in the systems of interventionism and socialism and cannot be solved unless the systems themselves are abolished. The principles of national welfare as conceived by our progressive planners conflict with the principles of international cooperation and division of production.

—HANS F. SENNHOLZ
How Can Europe Survive?

A REVIEWER'S NOTEBOOK

Revolution

by John Chamberlain

Martin Anderson, who is now a senior fellow of the Hoover Institution in California, worked for Ronald Reagan for more than seven years. He went through three presidential campaigns with Reagan, traveled with him to two Republican conventions, and spent considerable time in the White House helping to formulate the policy that has resulted in the so-called supply-side tax cuts. He knew Reagan as Larry Speakes, Don Regan, and Michael Deaver never knew him.

His book about the Reagan years, *Revolution* (New York: Harcourt Brace Jovanovich, 467 pp., $19.95), takes long views. Anderson did not approve of the Iran-Contra episode, which had American arms going to the Ayatollah, with profits to the Contras, but he thinks Reagan was the victim here of bad advice from William Casey, who was suffering from a brain tumor that made him an unreliable counselor.

In the long view, says Anderson, the Iran-Contra business will not bulk very large. The Reagan revolution, as Anderson sees it, must make allowance for occasional mistakes of judgment. What counts is the movement itself. It transcends personalities. What Anderson calls the "new capitalism" will continue to grow no matter who wins office in the 1988 elections.

Looking back over the past quarter century, Anderson asks what it is that links Barry Goldwater, Richard Nixon, and Ronald Reagan together. "What," he writes, "threw them high on the rocky beach of American politics? . . . Was their power due to their overwhelming personalities, to personal characteristics that will never be duplicated? Or was it due to something independent of any one person, to intellectual and political currents that produced first Goldwater, then Nixon, then Reagan?"

Anderson answers his own rhetorical questions by indirection. Barry Goldwater's smile, Richard Nixon's jabbing forefinger, and Ronald Reagan's friendly wave of the arm were hardly causative factors. "So far," says Anderson, "no one has attributed the move toward capitalism in China, and the Soviet Union, and New Zealand, and in dozens of other countries throughout the world, to the rise of these three personalities."

An intellectual revolution, says Anderson, has occurred worldwide. There may be a lull in America after Reagan's retirement in 1989, but "Communism, socialism, and any other form of dictator statism have proven to be intellectually bankrupt. The only vibrant, thriving political philosophy with a sound intellectual base remaining is capitalism. . . . Only when and if there is a seismic shift to the left in the intellectual world will we see a reversal of the political changes we are now witnessing."

Anderson thinks it is important to emphasize

that Ronald Reagan majored in economics at Eureka College in Illinois before the onset of the depression of the Thirties. "The economics he was taught," says Anderson, "was the old classical variety, straight from the works of Adam Smith, Alfred Marshall, Irving Fisher, Eugen Boehm-Bawerk, David Ricardo, and Jean Baptiste Say. John Maynard Keynes had not yet written the *General Theory*. Few complicated mathematical models were used for the exposition of economic theory; instead, the old economics relied on words, using the English language to explain basic principles."

Anderson himself relied on words when he undertook to formulate policy for Reagan in August of 1979. He was not impressed with the idea that there was a necessary trade-off between inflation and unemployment. The problem as he saw it was to reduce inflation and stimulate economic growth without, as he says, "having an economic bellyache." Economic growth would follow if Federal taxes were reduced from a point so high that it stifled the incentives for individuals to earn, save, and invest.

Anderson advocated a program of three years' duration of across-the-board tax cuts, especially in the higher, incentive-destroying marginal rates. The Kemp-Roth tax cut legislation was in accord with Anderson's advice to Reagan. Just to touch all bases, Reagan listened to a total of 74 economic advisers during the 1980 campaign. "Reaganomics," says Anderson, "came directly out of the heart of the Republican economic establishment of the United States. It represented the thinking of some of the best economic minds in the world."

The proof of the pudding is, of course, in the eating. During the five years between November 1982 and October 1987, says Anderson, "more wealth and services were produced than in any like period in history. There were 59 straight months of uninterrupted economic growth. . . . Over 13 million new jobs were created. . . . By the end of 1987 the United States was producing about seven and one-half times more every year than it produced the last year John F. Kennedy was President . . . the U.S. economy is now an economic colossus of such size and scope that we have no effective way to describe its power and reach."

Yet Martin Anderson concedes that the Federal deficits we have been running are too high. The trade deficit is worrisome, and too many Federal regulations remain unreformed. Reagan, he says, cannot expect credit for a perfection that is still elusive.

An Economic Bill of Rights

As far back as 1984, Anderson wrote an Economic Bill of Rights in which he called for a single amendment to the Constitution with five sections. *One,* he would limit the amount the federal government can spend. *Two,* he would require that the Federal budget be balanced. *Three,* he would prohibit wage and price controls. *Four,* he would give a line-item veto power to the President. And *Five,* he would require a two-thirds vote of Congress on all major spending bills.

Such a five-fold Constitutional amendment will obviously have to wait in an election year. But 31 states have endorsed the basic idea of the amendment, and it will surely be a prime subject for argument under either a Bush or a Dukakis regime.

Anderson's book got little of the publicity that went to Don Regan's. Anderson's own references to Don Regan are hardly flattering. "The thing that most disturbed me," he writes, "was the whispered word from one of my colleagues that Donald Regan donated a substantial amount of money to President Carter's campaign in 1980 as well as to Reagan's. Anybody who could contemplate supporting the economic policies of both Carter and Reagan earned a skeptical eye for at least a while."

Despite the emperor-wears-no-clothes revelations of Don Regan, Larry Speakes, and Michael Deaver, Anderson is certain that what Reagan and his comrades have done "is to shape America's policy agenda well into the twenty-first century. The prospects are nil for sharply progressive tax rates and big new social welfare programs."

Even though "Revolution" may be too strong a word to invoke here, the Reagan years at least represent a divide. □

PERESTROIKA: NEW THINKING FOR OUR COUNTRY AND THE WORLD
by Mikhail Gorbachev

Harper & Row, 10 East 53rd Street, New York, NY 10022 • 1987
255 pages • $19.95 cloth

Reviewed by William H. Peterson

Vigilance. National defense. Ideological power. Gamesmanship. These are the qualities that former President Richard Nixon—the man whom Nikita Khrushchev told "We will bury you"—counsels America to adopt in "Dealing with Gorbachev," his article in *The New York Times Magazine* last March.

The counsel is timely. For with *glasnost,* the new Soviet style of light and openness, with the new Intermediate-Range Nuclear Forces (INF) Treaty and Strategic Arms Reduction Talks (START) with the Soviet Union, and now with *perestroika,* the new Soviet policy of restructuring its economy and the title of a revealing if not subtly propagandistic book by 57-year-old General Secretary Mikhail Gorbachev, America is seemingly dealt a new hand by a shrewd and dapper poker player.

But is it really a new hand? I recall the New Economic Policy (NEP) of Lenin who, in 1921, so as to gain Western support and stem scarcity and popular unrest, allowed small businesses to operate privately and independent farmers to sell some of their produce at a profit. Stalin squelched NEP and launched the first Soviet Five-Year Plan in 1928. The rest, as is said, is history.

Today, however, renewed scarcity and at least some popular unrest, especially amid Soviet ethnic nationalities such as the Armenians, continue to dog the Soviet planners. Too, the planners are undoubtedly impressed and concerned by the economic headway made by the Red Chinese who, under the leadership of Deng Xiaoping, began to adopt some Western market techniques in 1976 after the death of Mao. And so now *perestroika* is prescribed for the USSR.

Gorbachev confesses that under recent Soviet communism:

> It became typical of many of our economic executives to think not of how to build up the national asset, but of how to put more material, labor and working time into an item to sell it at a higher price. Consequently, for all "gross output," there was a shortage of goods. We spent, in fact we are still spending, far more on raw materials, energy and other resources per unit of output than other developed nations. Our country's wealth in terms of natural and manpower resources has spoilt, one may even say, corrupted, us.

The confession goes on. Gorbachev complains that though the Soviet Union is the world's biggest producer of steel, raw materials, fuel, and energy it still has serious shortfalls in them "due to wasteful or inefficient use." Hard-currency earnings are depleted by having to import millions of tons of foreign grain when pre-Revolution Russia was the world's greatest grain exporter.

Gorbachev tells us his rockets can find Halley's comet and fly to Venus with amazing accuracy, yet "many Soviet household appliances are of poor quality." He concedes that at some administrative levels there emerged a disrespect for law and encouragement of "eyewash and bribery, servility and glorification," even "criminal acts." Widespread perplexity and indignation welled up in the population so that "the great values of the October Revolution and heroic struggle for socialism were being trampled underfoot."

Problems snowballed faster than they were resolved, Gorbachev further concedes. He says: "This, unfortunately, is not all. A gradual erosion of the ideological and moral values of our people began." The national problems of alcoholism (including moonshining), drug addiction, and crime are cited.

Thus was the Soviet Union by the first half of the 1980s "verging on crisis." This conclusion was announced at the Plenary Meeting of the Central Committee of the Soviet Communist Party in April 1985. Then the Soviet leaders, headed by Mikhail Gorbachev who had been named General Secretary only the month before, attacked the "spend-away" economy in which managers achieved "growth" through

construction of new plants and employment of more workers without reference to effective demand.

They similarly condemned the "gross-output" planning and production approach which stresses "weight" and "quantity" of goods, again without reference to market requirements including quality and cost control. The upshot was, as noted, installation of the momentous policy of *perestroika*—the restructuring of the Soviet economy. Broadly applied at home and abroad, says the General Secretary, perhaps with a twinkle in his eye, *perestroika* could lead to a "nuclear-free, non-violent world." Sure.

Yet details of *perestroika* are anything but spelled out. Yes, he notes that a key Law on State Enterprise has been adopted in which orders are imposed on industrial executives to align supply with demand. State businesses must henceforward, for example, engage in cost accounting. They must engage in vigorous competition.

But, says Gorbachev, we refuse to give up the planned economy. So he still speaks of "socialist planning," "socialist competition," and even "the socialist market"—however self-contradictory the phrase.

We reject the capitalist model of the West, he declares, adding that, properly implemented, "socialism can achieve much more than capitalism."

But does the rejection make sense? Are ends and means in harmony?

Or, is Mikhail Gorbachev trying to save face in this extraordinary book, to save but the trappings of socialism? Or, is he, like Lenin and the NEP before him, simply trying to buy time, to retreat two steps now so as to advance three steps later? I don't know the answers to the last couple of questions.

I do know, however, following Ludwig von Mises' 1922 classic, *Socialism,* that a centrally planned economy isn't a viable system. Without limited government and private property, socialist planners can't perform "economic calculation"—the use of market prices, including relative prices and derivative prices, to coordinate and enhance roundabout production. Without true market prices, in other words, socialism flies blind.

In any event, Nixon's entreaty for America makes sense: *En garde.* □

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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Thomas C. Stevens, chairman; Ridgway K. Foley, Jr., vice-chairman; Paul L. Poirot, secretary; H.F. Langenberg, treasurer.

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PERSPECTIVE

Reprise

Twenty years ago, at the time of another presidential election, I wrote my first little essay that appeared in *The Freeman*. It was called, "Each on His Own White Charger." (October 1968)

The theme was simple: The challenges of the time were to be solved by each of us acting morally and responsibly, not by some "political savior" on a white horse magically appearing in our midst with cure-alls.

Though two decades have passed, the challenge for believers in the market economy and limited government remains the same.

There are those who will argue that the cause of individual freedom has made progress. I would politely disagree. Our affairs private and public remain too much at the whim of congressmen, judges, bureaucrats, and a host of others. And, for every deregulation of business that has occurred, new burdens can easily be cited.

If anything, with the continued inflation of the money supply, and the passage of more and more laws, the task before us is as difficult as ever.

Each person living the most exemplary life he or she can continues as the best means for pursuing the ideals and the benefits of the free market and limited government.

We know we are surrounded by statists, socialists, and technocrats of varying tones. We know, too, we are forever being urged to compromise the virtues of individuality and free enterprise in the name of societal goodness, an alleged fairer distribution of goods and services, and one-worldness.

The pity of these pleas is that those who make them disregard the uncoerced market as the place where the fulfillment of what they seek is most likely to occur. They prefer the use of the police power, the State, in the achievement of their ends.

Mankind must have a code by which to live. The code existed before the creation of any current government. But the dos and don'ts of the Commandments and the Golden Rule do

not satisfy those who would create an improved (?) society by forcing everyone into their own molds at gunpoint.

What would happen to society and to the world if people truly respected one another, if people recognized that despite all efforts to educate and to civilize there always will be the unfit and the antisocial?

The harmony, the caring society and world we seek, are not to be found through the use of force in the peaceful activities of people whether it be in the arts, education, or the manufacture of patty cakes.

Salvation begins and ends with each of us as individuals. No one can instill it except ourselves. We can and do have teachers to help us understand and see, but the adoption of the final product depends upon ourselves. That has not changed in twenty years, nor will it in twenty times twenty more.

—EARL ZARBIN

Tokyo's Farmers

About 120 million people now live in Japan, 25.5 million of them in the huge Tokyo-Yokohama megalopolis. Because of soaring land prices, most Tokyo residents live in tiny homes or apartments, developers are resorting to constructing shopping malls underground, and one Japanese company is even planning floating office buildings to moor in Tokyo Bay.

Yet Yukio Noguchi, professor of public finance at Hitotsubashi University, argues that Tokyo does not suffer from an insufficient amount of land in absolute terms. (*Look Japan,* February 1988) Japan's population density, in fact, is similar to that of southern New England. Then why the soaring land prices?

As Japan's population has grown, its cities have expanded and swallowed up surrounding territory. But the farmers' rice paddies have often been encircled and left intact. According to Robert Chapman Wood, writing in the November 16, 1987, issue of *Forbes,* "Tokyo farms can be worth $230 and more per square foot (commercial land on Park Avenue in New York can command $65 per square foot), and their value has been rising at up to 50 percent per year." But few suburban farmers sell. Why should they? They are taxed only on the value of their land for agricultural purposes, while they face enormous capital gains taxes if they sell. And if they can't make a profit in the suburbs, local governments often give them a special subsidy.

Some rice paddies have been converted to housing in recent years, but nowhere nearly enough to dent the housing shortage. Only 47 per cent of the land within metropolitan Tokyo has been developed. And 30 per cent of metropolitan Tokyo is still used for farmland.

As Wood points out, Japan "maintains a maze of regulations and tax benefits that attempt to protect farms, tenants, rickety old urban houses, and small stores from the modern world." Because of these regulations and taxes, "Tokyo's residents live in minuscule apartments and houses."

Japanese rice farmers enjoy a privileged status because urban Japanese "want to live the life of a farmer vicariously." But they must pay the price—as taxpayers, in the form of subsidies; and as consumers, in the form of crowded living space.

—BBG

The Value of the Market

The central value of the free market is that it is inextricably intertwined with human freedom, both spiritually and materially. What the past 50 years of the world socialist experiment have demonstrated beyond reasonable doubt is that if human beings are to be free in spirit and of mind, they must first be free to make their individual market choices. Deprived of the latter, they are automatically deprived of the former. Granted freedom of spirit, they demand freedom of the marketplace.

—CHARLES D. SNELLING

THE FREEMAN
IDEAS ON LIBERTY

Fairness and Justice: Process vs. Results

by Walter E. Williams

In pursuit of what Friedrich A. Hayek calls "the mirage of social justice," Americans have turned their faces against liberal values and are rapidly embracing the immorality of socialism. In an effort to achieve social justice, decent, well-meaning people who hold little brief for despotism are unwittingly laying its infrastructure.

Throughout American history we have been recognized as the beacon and hope of the world's freedom-cherishing people. This reputation was not earned because somehow Americans are congenitally morally superior people. To the contrary, our cultural-ethnic-religious mosaic consists of descendants of French, English, German, Irish, Jews, Greeks, Italians, Japanese, Chinese, Africans, Protestants, Catholics, and a host of other divisions of people who have been slaughtering one another in their homelands for centuries.

Therefore, it is not so much the nature of America's people that accounts for our heritage of freedom as it is the rules of the game we have chosen to govern our relationships. At the heart of these rules are classical liberal values such as: (1) individual freedom and mutually beneficial voluntary exchange, (2) freedom of enterprise in the form of self-regulating markets without government intervention, (3) private property rights, freedom of contract and rule of law, and (4) limited government.

While no society has ever achieved all of these liberal values, they were once the dominant theme of American values. In today's America, the liberal values of John Locke, Adam Smith, Thomas Jefferson, and George Mason are held in contempt, and in practice have been eroded by unrestrained political intervention. The liberal values suffering the greatest assault are those calling for rule of law and limited government.

Rule of law (or rule by *legis,* the Latin term for law) means that government must be bound by fixed and predictable rules and all people are governed by the same laws. Today's America is increasingly becoming rule by privileges, deriving from the Latin, *privilegium,* for private law. Limited government and a republican form of government, as envisaged by our Constitution, have little meaning in practice as our lives become more and more controlled by some level of government, most often the federal government.

The equal protection clause of the Fourteenth Amendment has come to mean one thing for "protected" minorities and something different for everyone else. Duties and responsibilities imposed on one class of citizens, say younger people, are forgiven for another class of people, say older people. These and many other actions, including special laws for the handi-

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capped and special tax treatment for some individuals, are examples of rule by privileges where a person's status governs the application of the law.

Decisions formerly seen as those of state and local governments such as schooling, highway construction, and public health are now influenced and/or controlled at the Federal level. Privacy rights formerly taken for granted are now surrendered to distant government bureaucracies such as the Internal Revenue Service, the Social Security Administration, and others. While these government encroachments may seem inconsequential to today's citizen, the American who died at the turn of the century would be shocked at our loss of liberty and privacy. Perhaps more insidious is that most of us do not realize our loss of liberty or privacy until we come to claim a presumed right (such as being able to leave the country privately with more than $10,000 in currency or other negotiable instruments) and find it gone.

Why the Loss of Liberty?

A serious thinker can list many causes for the diminution of liberty in America; however, at bedrock lies the strong American sense of doing good and guaranteeing justice and fairness to our fellow man. In the pursuit of noble goals, with great misunderstanding, we are standing justice and fairness on their heads. While some Americans use these stated goals to accomplish personal hidden agendas, most Americans, with the best of intentions, just have not given much thought to what the policies they support do to justice and fairness.

Part of the problem is that results or outcomes of human relationships are often seen as criteria for the presence or absence of justice and fairness. Outcomes frequently used as barometers of justice and fairness are: race and sex statistics on income and unemployment, income distribution in general, occupational distribution, wealth ownership, and other measures of socioeconomic status.

Despite the broad acceptance of outcomes as measures of justice and fairness by the public, courts, and politicians, we must ask whether outcomes can provide us with any meaningful clues about fairness or justice. Let us examine this issue using a simplified construct—the game of poker. The specific question we ask is: can we tell whether a poker game is fair by having information only about the game's outcome? Suppose we know that Harry, John, and Mary play poker regularly. Harry wins 75 per cent of the time while John and Mary win 15 and 10 per cent of the time respectively.

Knowing only this outcome of the game, we ask: is the game fair? The evidence before us is that Harry has 75 per cent of the winnings distribution while John and Mary share the balance. Was the game fair? Was there "poker justice"? Would an equal distribution (33.3 each) be fairer? What is the standard for judging what outcome is fair, just, or equitable?

It is clear that determining a standard for a fair distribution of winnings would be quite elusive if not impossible. The only way we can have any hope of ascertaining the fairness of the game is to examine instead the *process* of the game. In an examination of process, we would ask such questions as: (1) was participation in the game voluntary or not, (2) were there neutral rules, and (3) did every player play by those rules?

Harry's winning 75 per cent of the time is no indicator of the game's fairness. Harry might be an astute player or his high winnings could be the result of cheating. Similarly, if the winnings distribution had been 33 per cent each, we still would not know whether the game was fair. John and Mary might be just as good players as Harry, or they might have joined to extort part of Harry's winnings in the name of equality, or John and Mary could be cheating. Information on the distribution of winnings allows us to make no unambiguous statements about the fairness of the game.

The rules of any game seek to establish and restrain the nature of the relationships among the participants. Among the rules of poker: you cannot look at your opponent's cards; cards must be dealt from the top of the deck; a full house beats a pair; and so on. In basketball, football, baseball, and other sports, there are agreed-upon rules governing the conduct of the game. In some games, there are referees to insure that participants play by the rules and to assess penalties on those who violate the rules.

We should carefully note that the purpose of the rules of the game is *not* that of determining the winner of the game. Similarly the role of the referee is not that of choosing game winners; nor is it his role to be a member of either team. His role is simply that of an impartial observer enforcing neutral game rules. Were referees to play the game, or if the game rules *ex ante* determined the winner, there would be common agreement that the game was not fair.

Our lives are games in the sense that we test our skills, courage, and endurance in the pursuit of pleasurable things for ourselves, families, and our fellow man. The payoff (winnings) is frequently measured in income, wealth, and other measures of socioeconomic status. Knowing one person's income is $200,000 a year while another's is $12,000 tells us little about fairness. The difference in income could be a result of pillage and plunder, one person's being forcefully prevented from realizing his earnings potential, or one person's simply being more productive than his counterpart. All these possibilities, and I am sure others, are consistent with income differences.

Effort Rewarded

In free markets, characterized by voluntary relationships, differences in wealth and income, for the most part, reflect one's effort and capacity to serve his fellow man. Rich people like Michael Jackson and Pavarotti give immense pleasure to many people. Similarly, producers of Barbie Dolls, antibiotics, or computers satisfy the desires of their fellow men who reward them with dollars. Other people satisfy their fellow man in less dramatic, but no less important, ways as grocery clerks, farmers, and taxi drivers.

Therefore, in a society of voluntary relationships income is not "distributed"; it is earned —earned by individual efforts to please one's fellow man. One person is not poor because another is rich. The fact that people earn income reflects the morality of free markets. It is their ability and willingness to please their fellow man that enables them to have a claim on the productive assets of the society.

In this sense, the market is a strong disciplinarian. It commands that, if for any reason, you do not please your fellow man, you have no contractual claim on the goods society produces. Of course, there are people who cannot or will not please their fellow man. Only charity and gifts permit them to have access to the goods produced by society. However, man has found other ways whereby he can avoid pleasing his fellow man and still have claims on society's goods, namely through theft, intimidation, and coercion. Practices such as looting and plunder have all too frequently characterized human history. A more recently perfected technique is through legalized theft where people exploit the coercive powers of government to take the property of their fellow man. Examples of the latter are the multi-billion dollar programs created by the United States Congress where the property of one American is confiscated and given to another American to whom it does not belong.

Various forms of pillage, plunder, and looting (where government allows one American to live at the expense of another American) violate neutral, fair rules of the game of life. Occupation and business regulation are other examples of unfair, non-neutral rules of the game, where the government in effect tells one citizen that he will be granted a right or opportunity that will be denied another citizen. Much of government activity consists of privilege-granting where a person's status determines what laws he will be subjected to and how these laws shall be applied.

Indeed there is considerable unfairness in American society, but it cannot be detected, much less eliminated, by constant focus on outcomes. Instead, we need to focus our energies on examination of process and the rules of the game. Pursuit of the mirage of social justice, seen as being determined by outcomes, leads to gross human rights abuse. History is filled with episodes where social goals were set, and whenever the rights of individuals interfered with the attainment of the goals, those rights were brutally suppressed by an all-powerful state. □

When Voting Makes No Sense

by Tibor R. Machan

This is the season for voting. We will be urged to go out and vote, never mind for whom or for what. Voting will be praised by public-spirited types across this great land.

There never seems to be an end to people who love wagging their fingers at us. Election year is another opportunity for them to indulge in this vigorous exercise. But are they right? Should we really feel so bad if we do not vote? Is it so irresponsible to stay home or go fishing on election day?

Let me answer this somewhat personally. As a naturalized citizen I always vote. Even when I spent a couple of Novembers working in Europe, I wrote for ballots and made sure they got back in time. I am a dutiful voter, indeed.

But it takes its toll. For me to have any confidence in my repeated political acts, I have had to become a full-time political person.

In my life politics is virtually everything. I am certainly a man without hobbies. I barely have time for my family and I am able to keep up with my profession only because it largely revolves around studying politics.

For someone to have any reasonable confidence of being a good voter—to do this task in good conscience—one has to prepare for voting in a relentless, demanding fashion. In my case this has meant seeking out the best political principles and then voting in the way that most effectively supports these principles. This requires extensive study—not just reading the newspaper, following the candidates' records, examining the various referenda, knowing the persons likely to accompany the candidate to office, and so on. Most importantly it requires keeping one's mind on some very big questions, such as "What is justice?" "Is freedom more important than security?" "What is best for a human community?" "How far should democracy go in a country?" Can you imagine someone being a competent, conscientious voter who has not given thought to these issues? I cannot.

But there is more to our problem. The task of voting in an era of omnipresent government is unbelievably demanding. It is doubtful that one per cent of those who go to the polls have made a real effort to understand all the issues. How could they? It is certainly not their fault that in order to be politically savvy one needs to be almost omniscient.

The people we send to office are embarking on missions best undertaken by the Almighty. They have to decide on issues ranging from what fish need to be preserved to where to build the next interstate highway; from how best to fight AIDS to whether surrogate motherhood for pay should be permitted; from whether a judge is suited to sit on the Supreme Court to how much subsidy money the tobacco farmers of North Carolina should receive; from how many helicopters Angolan freedom fighters need to how to control trading on the New York Stock Exchange. And this only at the Federal level!

Because government is now involved in so many things, and politicians have to make so many complicated decisions, every politician

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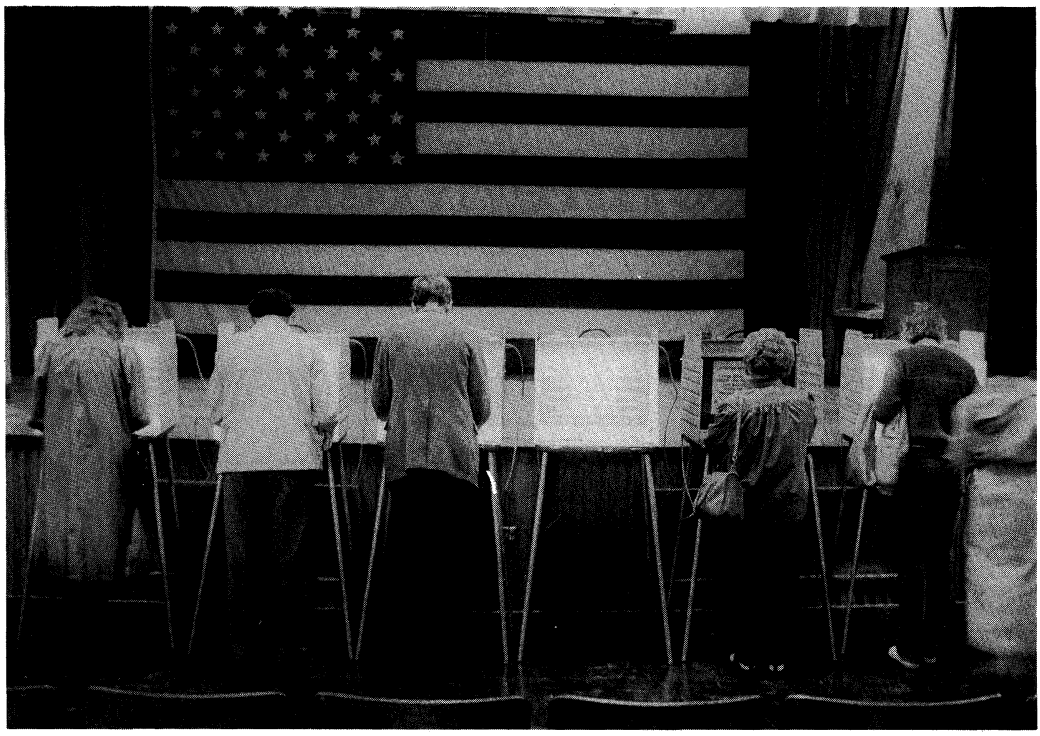

WIDE WORLD

must possess an incredible array of knowledge, talent, and skills. There is no job description that fits such people—if we can find them. Can anyone feel totally confident about voting for one over the other?

The Scope of Government

One reason I suspect the Founding Fathers and framers tried to build a society with a limited government wasn't that they worried about the size of government. It's the scope of government that matters. They meant for all the people to participate in the affairs of government, so they wanted those affairs to be relatively specific. That is one very good reason to limit the power of government. In the market we can judge the baker, restaurateur, dentist, carpet cleaner, or banker, and, if we deem their work inferior, we can go elsewhere. In government, however, we have to cast a vote for people whom we cannot judge, since we have little idea about what they will do; and even if we have some inkling, we have few skills to judge them at their tasks.

So if you stay home on election day, don't feel guilty. The guilty ones are those who have turned our governments into busybody institutions that have acquired tasks and powers no one can keep an eye or mind on, let alone evaluate. Unlimited government is incompatible with representative democracy. □

The Political Process

IDEAS ON LIBERTY

Legislatures, laws, courts, constabularies, bureaucracies can do little more than exert a mild influence along lines consistent with the current consensus. The consensus moves this way or that in accord with its content; it rises when filled with truths and virtues and sinks when bogged down with nonsense. So, what I can do about the government depends upon the quality of the ideas I feed into the consensus. This defines both my limitation and my potentiality.

—LEONARD E. READ

Capitalism and the Jews

by Milton Friedman

Editors' Note: *"Capitalism and the Jews" was originally presented as a lecture before the Mont Pelerin Society in 1972. It subsequently was published in England and Canada and appears here without significant revision.*

I. PARADOX EXPOSED

Postwar Collectivism in the West

Immediately after the Second World War, the prospects for freedom looked bleak. The war had produced an unprecedented centralization of economic controls in every belligerent country. The "socialists of all parties," to whom F. A. Hayek dedicated his brilliant polemic *The Road to Serfdom,* seemed well on their way to establishing central planning as the standard for peace as for war, pointing triumphantly to the full employment that had been produced by inflationary war finance as decisive evidence for the superiority of central planning over capitalist chaos. And, if that occurred, there seemed little hope of halting the slide toward full-fledged collectivism.

Fortunately, those fears have not been realized over the intervening years. On the contrary, government inefficiency together with the clear conflict between central planning and individual freedom served to check the trend towards collectivism. In Britain, in France, in the U.S., war-time controls were dismantled and market mechanisms were given greater play. In West Germany, the courageous action of Ludwig Erhard in ending controls in the summer of 1948 triggered the so-called German economic miracle. Even behind the Iron Curtain, Yugoslavia broke with its Soviet masters, rejected detailed control of the economy, and treated us to the surprising vision of creeping capitalism in an avowedly communist society.

Unfortunately, these checks to collectivism did not check the growth of government. Rather, they diverted that growth from central direction of the economy to central control of the distribution of the product, to the wholesale transfer of income from some members of the community to others.

The Collectivist Trend in Ideas

Much more important and much more relevant to our society, the favorable trends in the world of affairs were not paralleled in the world of ideas. For a time, there was an intellectual reaction against governmental intervention. Some of us optimistically envisioned a resurgence of liberal values, the emergence of a new trend of opinion favorable to a free society. But any such resurgence was spotty and short-lived. Intellectual opinion in the West has again started moving in a collectivist direction. Many of the slogans are individualist—participatory democracy, down with the establishment, "do your own thing," "power to the people." But the slogans are accompanied by attacks on pri-

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vate property and free enterprise—the only institutions capable of achieving the individualistic objectives. They are accompanied by a demand for centralized political power—but with "good" people instead of "bad" people exercising the power.

West Germany is perhaps the most striking example of the paradoxical developments in the world of affairs and the world of ideas. Who could ask for a better comparison of two sets of institutions than East and West Germany have provided in the past two decades? Here are people of the same blood, the same civilization, the same level of technical skill and knowledge, torn asunder by the accidents of warfare. The one adopts central direction; the other adopts a social market economy. Which has to build a wall to keep its citizens from leaving? On which side of the wall is there tyranny and misery; on which side, freedom and affluence? Yet despite this dramatic demonstration, despite the Nazi experience—which alone might be expected to immunize a society for a century against collectivism—the intellectual climate in Germany, I am told, is overwhelmingly collectivist—in the schools, the universities, the mass media alike.

This paradox is a major challenge to those of us who believe in freedom. Why have we been so unsuccessful in persuading intellectuals everywhere of our views? Our opponents would give the obvious answer: because we are wrong and they are right. Until we can answer them and ourselves in some other way, we cannot reject their answer, we cannot be sure we are right. And until we find a satisfactory answer, we are not likely to succeed in changing the climate of opinion.

The Jews as an Example of the Paradox

My aim here is not to give a ready answer—for I have none. My aim is rather to examine a particular case of paradox—the attitude of Jews toward capitalism. Two propositions can be readily demonstrated: first, the Jews owe an enormous debt to free enterprise and competitive capitalism; second, for at least the past century the Jews have been consistently opposed to capitalism and have done much on an ideological level to undermine it. How can these propositions be reconciled?

I was led to examine this paradox partly for obvious personal reasons. Some of us are accustomed to being members of an intellectual minority, to being accused by fellow intellectuals of being reactionaries or apologists or just plain nuts. But those of us who are also Jewish are even more embattled, being regarded not only as intellectual deviants but also as traitors to a supposed cultural and national tradition.

This personal interest was reinforced by the hope that study of this special case might offer a clue to the general paradox—typified by West Germany where Jews play a minor role. Unfortunately, that hope has not been fulfilled. I believe that I can explain to a very large extent the anti-capitalist tendency among Jews, but the most important elements of the explanation are peculiar to the special case and cannot readily be generalized. I trust that others will be more successful.

II. THE BENEFIT JEWS HAVE DERIVED FROM CAPITALISM

An Anecdote and Some History

Let me start by briefly documenting the first proposition: that the Jews owe an enormous debt to capitalism. The feature of capitalism that has benefited the Jews has, of course, been competition.[1] Wherever there is a monopoly, whether it be private or governmental, there is room for the application of arbitrary criteria in the selection of the beneficiaries of the monopoly—whether these criteria be color of skin, religion, national origin or what not. Where there is free competition, only performance counts. The market is color blind. No one who goes to the market to buy bread knows or cares whether the wheat was grown by a Jew, Catholic, Protestant, Muslim, or atheist; by whites or blacks. Any miller who wishes to express his personal prejudices by buying only from preferred groups is at a competitive disadvantage, since he is keeping himself from buying from the cheapest source. He can express his prejudice, but he will have to do so at

A Jewish banker lends money to a nobleman. (1487) THE BETTMANN ARCHIVE

his own expense, accepting a lower monetary income than he could otherwise earn.

A recent personal experience illuminates sharply the importance of competition. Some years ago, I attended an International Monetary Conference held in Montreal. The persons there consisted, on the one hand, of members of the Conference, who include the two top executives of the major commercial banks throughout the world; on the other, of persons like myself invited as speakers or participants in panel discussions. A conversation with an American banker present who recounted a tale of anti-Semitism in American banking led me to estimate roughly the fraction of the two groups who were Jewish. Of the first group—the bankers proper—I estimated that about 1 per cent were Jewish. Of the much smaller second group, the invited participants in the program, roughly 25 per cent were Jewish.

Why the difference? Because banking today is everywhere monopolistic in the sense that there is no free entry. Government permission or a franchise is required. On the other hand, intellectual activity of the kind that would recommend persons for the program is a highly competitive industry with almost completely free entry.

This example is particularly striking because banking is hardly a field, like, say, iron and steel, in which Jews have never played an important role. On the contrary, for centuries Jews were a major if not dominant element in banking and particularly in international banking. But when that was true, banking was an industry with rather free entry. Jews prospered in it for that reason and also because they had a comparative advantage arising from the Church's views on usury, the dispersion of Jews throughout the world, and their usefulness to ruling monarchs precisely because of the isolation of the Jews from the rest of the community.[2]

This anecdote illuminates much history. Throughout the nearly two thousand years of the Diaspora, Jews were repeatedly discriminated against, restricted in the activities they could undertake, on occasion expelled *en masse,* as in 1492 from Spain, and often the object of the extreme hostility of the peoples

among whom they lived. They were able nonetheless to exist because of the absence of a totalitarian state, so that there were always some market elements, some activities open to them to enter. In particular, the fragmented political structure and the numerous separate sovereignties meant that international trade and finance in particular escaped close control, which is why Jews were so prominent in this area. It is no accident that Nazi Germany and Soviet Russia, the two most totalitarian societies in the past two thousand years (modern China perhaps excepted), also offer the most extreme examples of official and effective anti-Semitism.

If we come to more recent time, Jews have flourished most in those countries in which competitive capitalism had the greatest scope: Holland in the sixteenth and seventeenth centuries, and Britain and the U.S. in the nineteenth and twentieth centuries, Germany in the late nineteenth and early twentieth century—a case that is particularly pertinent when that period is compared with the Hitler period.[3]

Freedom of Entry and Jewish Representation

Moreover, within those countries, Jews have flourished most in the sectors that have the freest entry and are in that sense most competitive. Compare the experience of the Jews in banking, that I have referred to, with their experience in retail trade, which has been almost a prototype of the textbook image of perfect competition and free entry. Or compare their minor role in large industry with their prominence in the professions such as law, medicine, accountancy and the like.[4] Though there are barriers to entry in the professions, too, once past the initial barriers, there is a large measure of free competition for custom. Even the differences within the professions illustrate my theme. In the U.S., for which I know the details, there was for a long time a major difference between medicine and law in the extent to which state licensure was an effective bar to entry. For reasons that are not relevant here, there was significant restriction of entry in medicine, relatively little in law. And Jews were proportionately much more numerous in law than in medicine.

The movie industry in the U.S. was a new industry and for that reason open to all. Jews became a major factor and this carried over to radio and television when they came on the scene. But now that government control and regulation has become more and more important, I am under the impression that the Jewish role in radio and T.V. is declining.

Capitalism and Israel

A rather different example of the benefits Jews have derived from competitive capitalism is provided by Israel, and this in a dual sense.

First, Israel would hardly have been viable without the massive contributions that it received from world Jewry, primarily from the U.S., secondarily from Britain and other Western capitalist countries. Suppose these countries had been socialist. The hypothetical socialist countries might conceivably have contributed, but if so they would have done so for very different reasons and with very different conditions attached. Compare Soviet aid to Egypt or official U.S. aid to Israel with private contributions. In a capitalist system, any group, however small a minority, can use its own resources as it wishes, without seeking or getting the permission of the majority.

Second, within Israel, despite all the talk of central control, the reality is that rapid development has been primarily the product of private initiative. After my first extended visit to Israel two decades ago, I concluded that two traditions were at work in Israel: an ancient one, going back nearly two thousand years, of finding ways around governmental restrictions; a modern one, going back a century, of belief in "democratic socialism" and "central planning." Fortunately for Israel, the first tradition has proved far more potent than the second.

To summarize: Except for the sporadic protection of individual monarchs to whom they were useful, Jews have seldom benefited from governmental intervention on their behalf. They have flourished when and only when there has been a widespread acceptance by the public at large of the general doctrine of nonintervention, so that a large measure of competitive capitalism and of tolerance for all groups has prevailed. They have flourished then de-

spite continued widespread anti-Semitic prejudice because the general belief in non-intervention was more powerful than the specific urge to discriminate against the Jews.

III. THE ANTI-CAPITALIST MENTALITY OF THE JEWS

Despite this record, for the past century, the Jews have been a stronghold of anti-capitalist sentiment. From Karl Marx through Leon Trotsky to Herbert Marcuse, a sizable fraction of the revolutionary anti-capitalist literature has been authored by Jews. Communist parties in all countries, including the party that achieved revolution in Russia but also present-day Communist parties in Western countries, and especially in the U.S.,[5] have been run and manned to a disproportionate extent by Jews—though I hasten to add that only a tiny fraction of Jews have ever been members of the Communist party. Jews have been equally active in the less-revolutionary socialist movements in all countries, as intellectuals generating socialist literature, as active participants in leadership, and as members.

Coming still closer to the center, in Britain the Jewish vote and participation is predominantly in the Labor party, in the U.S., in the left wing of the Democratic party. The party programs of the so-called right-wing parties in Israel would be regarded as "liberal," in the modern sense, almost everywhere else. These phenomena are so well known that they require little elaboration or documentation.[6]

IV. WHY THE ANTI-CAPITALIST MENTALITY?

How can we reconcile my two propositions? Why is it that despite the historical record of the benefits of competitive capitalism to the Jews, despite the intellectual explanation of this phenomenon that is implicit or explicit in all liberal literature from at least Adam Smith on, the Jews have been disproportionately anti-capitalist?

We may start by considering some simple yet inadequate answers. Lawrence Fuchs, in a highly superficial analysis of *The Political Behavior of American Jews,* argues that the anti-capitalism of the Jews is a direct reflection of values derived from the Jewish religion and culture. He goes so far as to say, "if the communist movement is in a sense a Christian heresy, it is also Jewish orthodoxy—not the totalitarian or revolutionary aspects of world communism, but the quest for social justice through social action."[7] Needless to say—a point I shall return to later in a different connection—Fuchs himself is a liberal in the American sense. He regards the political liberalism of the Jews in this sense as a virtue, and hence is quick to regard such liberalism as a legitimate offspring of the Jewish values of learning, charity, and concern with the pleasures of this world. He never even recognizes, let alone discusses, the key question whether the ethical end of "social justice through social action" is consistent with the political means of centralized government.

Werner Sombart

This explanation can be dismissed out-of-hand. Jewish religion and culture date back over two millennia; the Jewish opposition to capitalism and attachment to socialism, at the most, less than two centuries. Only after the Enlightenment, and then primarily among the Jews who were breaking away from the Jewish religion, did this political stance emerge. Werner Sombart, in his important and controversial book, *The Jews and Modern Capitalism,* first published in 1911, makes a far stronger case that Jewish religion and culture implied a capitalist outlook than Fuchs does that it implied a socialist outlook. Wrote Sombart, "throughout the centuries, the Jews championed the cause of individual liberty in economic activity against the dominating view of the time. The individual was not to be hampered by regulations of any sort. I think that the Jewish religion has the same leading ideas as capitalism. . . . The whole religious system is in reality nothing but a contract between Jehovah and his chosen people. . . . God promises something and gives something, and the righteous must give Him something in return. Indeed, there was no community of interest between God and man which could not

be expressed in these terms—that man performs some duty enjoined by the Torah and receives from God a *quid pro quo*."[8]

Sombart goes on to discuss the attitude toward riches and poverty in the Old and the New Testament. "You will find," he writes, "a few passages [in the Old Testament and the Talmud] wherein poverty is lauded as something nobler and higher than riches. But on the other hand you will come across hundreds of passages in which riches are called the blessing of the Lord, and only their misuse or their dangers warned against." By contrast, Sombart refers to the famous passage in the New Testament that "it is easier for a Camel to go through a needle's eye than for a rich man to enter into the Kingdom of God" and remarks, "as often as riches are lauded in the Old Testament, they are damned in the New. . . . The religion of the Christians stands in the way of their economic activities. . . . The Jews were never faced with this hindrance." He concludes, "Free trade and industrial freedom were in accordance with Jewish law, and therefore in accordance with God's will."[9]

Sombart's book, I may say, has in general had a highly unfavorable reception among both economic historians in general and Jewish intellectuals in particular, and indeed, something of an aura of anti-Semitism has come to be attributed to it. Much of the criticism seems valid but there is nothing in the book itself to justify any charge of anti-Semitism though there certainly is in Sombart's behavior and writings several decades later. Indeed, if anything I interpret the book as philo-Semitic. I regard the violence of the reaction of Jewish intellectuals to the book as itself a manifestation of the Jewish anti-capitalist mentality. I shall return to this point later.

A more balanced judgment than either Fuchs' or Sombart's with which I am in full accord is rendered by Nathan Glazer, who writes, "It is hard to see direct links with Jewish tradition in these attitudes;. . . One thing is sure: it is an enormous oversimplification to say Jews in Eastern Europe became socialists and anarchists because the Hebrew prophets had denounced injustice twenty-five hundred years ago. . . . The Jewish religious tradition probably does dispose Jews, in some subtle way, toward liberalism and radicalism, but it is not easy to see in present-day Jewish social attitudes the heritage of the Jewish religion."[10]

Jews, Intellectualism, and Anti-Capitalism

A second simple explanation is that the Jewish anti-capitalist mentality simply reflects the general tendency for intellectuals to be anti-capitalist plus the disproportionate representation of Jews among intellectuals. For example, Nathan Glazer writes, "The general explanations for this phenomenon [the attachment of the major part of the intelligentsia to the Left] are well known. Freed from the restraints of conservative and traditional thinking, the intelligentsia finds it easier to accept revolutionary thinking, which attacks the established order of things in politics, religion, culture, and society. . . . Whatever it is that affected intellectuals, also affected Jews."[11] Glazer goes on, however, to qualify greatly this interpretation by citing some factors that affected Jews differently from other intellectuals. This explanation undoubtedly has more validity than Fuchs' simple-minded identification of anti-capitalism with Jewish religion and culture. As the West German example quoted earlier suggests, non-Jewish intellectuals are capable of becoming dominantly collectivist. And there is no doubt that the intellectual forces Glazer refers to affected Jewish intellectuals along with non-Jewish. However, the explanation seems highly incomplete in two respects. First, my impression is that a far larger percentage of Jewish intellectuals than of non-Jewish have been collectivist. Second, and more important, this explanation does not account for the different attitudes of the great mass of Jews and non-Jews who are not intellectual. To explain this difference we must dig deeper.

A third simple explanation that doubtless has some validity is the natural tendency for all of us to take the good things that happen to us for granted but to attribute any bad things to evil men or an evil system. Competitive capitalism has permitted Jews to flourish economically and culturally because it has prevented anti-Semites from imposing their values on others, and

from discriminating against Jews at other people's expense. But the other side of that coin is that it protects anti-Semites from having other people's values imposed on them. It protects them in the expression of their anti-Semitism in their personal behavior so long as they do it at their own expense. Competitive capitalism has therefore not eliminated social anti-Semitism. The free competition of ideas that is the natural companion of competitive capitalism might in time lead to a change in tastes and values that would eliminate social anti-Semitism but there is no assurance that it will. As the New Testament put it, "In my Father's house are many mansions."

No doubt, Jews have reacted in part by attributing the residual discrimination to "the System." But that hardly explains why the part of the "system" to which the discrimination has been attributed is "capitalism." Why not, in nineteenth-century Britain, to the established church and the aristocracy; in nineteenth- and twentieth-century Germany, to the bureaucracy; and in twentieth-century U.S., to the social rather than economic establishment. After all, Jewish history surely offers more than ample evidence that anti-Semitism has no special connection with a market economy. So this explanation, too, is unsatisfactory.

I come now to two explanations that seem to me much more fundamental.

Judaism and Secularism

The first explanation, which has to do with the particular circumstances in Europe in the nineteenth century, I owe to the extremely perceptive analysis of Werner Cohn in his unpublished Ph.D. dissertation on the "Sources of American Jewish Liberalism." Cohn points out that:

> Beginning with the era of the French revolution, the European political spectrum became divided into a "Left" and a "Right" along an axis that involved the issue of secularism. The Right (conservative, Monarchical, "clerical") maintained that there must be a place for the church in the public order; the Left (Democratic, Liberal, Radical) held that there can be no (public) Church at all. . . .
>
> The axis separating left from right also formed a natural boundary for the pale of Jewish political participation. It was the Left, with its new secular concept of citizenship, that had accomplished the Emancipation, and it was only the Left that could see a place for the Jews in public life. No Conservative party in Europe—from the bitterly hostile Monarchists in Russia through the strongly Christian "noines" in France to the amiable Tories in England—could reconcile itself to full Jewish political equality. Jews supported the Left, then, not only because they had become unshakeable partisans of the Emancipation, but also because they had no choice; as far as the internal life of the Right was concerned, the Emancipation had never taken place, and the Christian religion remained a prerequisite for political participation.

Note in this connection that the only major leaders of Conservative parties of Jewish origin—Benjamin Disraeli in England, Friedrich Julius Stahl in Germany—were both professing Christians (Disraeli's father was converted, Stahl was baptized at age 19).

Cohn goes on to distinguish between two strands of Leftism: "rational" or "intellectual" and "radical." He remarks that "Radical leftism . . . was the only political movement since the days of the Roman empire in which Jews could become the intellectual brethren of non-Jews . . . while intellectual Leftism was Christian at least in the sense of recognizing the distinction between 'religious' and 'secular,' radical Leftism—eschatological socialism in particular—began to constitute itself as a new religious faith in which no separation between the sacred and the profane was tolerated . . . [Intellectual-Leftism] offered [the Jews] a wholly rational and superficial admission to the larger society, [radical Leftism], a measure of real spiritual community."

I share Glazer's comment on these passages: "I do not think anyone has come closer to the heart of the matter than has the author of these paragraphs."

Cohn's argument goes far to explain the important role that Jewish intellectuals played in the Marxist and socialist movement, the almost

universal acceptance of "democratic socialism" by the European Jews in the Zionist movement, particularly those who emigrated to Palestine, and the socialist sentiment among the German Jewish immigrants to the United States of the mid-nineteenth century and the much larger flood of East European Jews at the turn of the century.

Yet by itself it is hard to accept Cohn's point as the whole explanation for the anti-capitalist mentality of the Jews. In the United States, from the very beginning, the separation of church and state was accepted constitutional doctrine. True, the initial upper class was Christian and Protestant, but that was true of the population as a whole. Indeed, the elite Puritan element was, if anything, pro-Semitic. As Sombart points out in reconciling his thesis about the role of Jews in capitalist development with Max Weber's about the role of the Protestant Ethic in capitalist development, the Protestants, and the Puritans especially, went back to the Old Testament for their religious inspiration and patterned themselves on the ancient Hebrews. Sombart asserts: "Puritanism *is* Judaism."[12] Cohn too emphasizes this phenomenon, pointing to Puritan tolerance toward Jews in the colonial era, despite their general intolerance toward other religious sects.[13]

To come down to more recent times in the United States, Theodore Roosevelt was highly popular among the Jews partly because of his willingness to object publicly to Russian pogroms. Outside of the closely knit socialist community in New York most Jews probably were Republicans rather than Democrats until the 1920s, when first Al Smith and then Franklin Delano Roosevelt produced a massive shift to the Democrats from both the Right and the Left. The shift from the Left betokened a weakening of the European influence, rather than being a manifestation of it. Yet despite that weakening influence, the American Jewish community, which now consists largely of second and third and later generation Americans, retains its dominant leftish cast.

The final explanation that suggests itself is complementary to Cohn's yet not at all identical with it. To justify itself by more than the reference to the alleged role of the Jews in Christ's crucifixion, anti-Semitism produced a stereotype of a Jew as primarily interested in money, as a merchant or moneylender who put commercial interests ahead of human values, who was money-grasping, cunning, selfish and greedy, who would "jew" you down and insist on his pound of flesh. Jews could have reacted to this stereotype in two ways: first, by accepting the description but rejecting the values that regarded these traits as blameworthy; secondly, by accepting the values but rejecting the description. Had they adopted the first way, they could have stressed the benefits rendered by the merchant and by the moneylender—recalling perhaps Bentham's comment that "the business of a money-lender . . . has no where nor at any time been a popular one. Those who have the resolution to sacrifice the present to the future, are natural objects of envy to those who have sacrificed the future to the present. The children who have eat their cake are the natural enemies of the children who have theirs. While the money is hoped for, and for a short time after it has been received, he who lends it is a friend and benefactor: by the time the money is spent, and the evil hour of reckoning is come, the benefactor is found to have changed his nature, and to have put on the tyrant and the oppressor. It is oppression for a man to reclaim his own money; it is none to keep it from him."[14]

Similarly, Jews could have noted that one man's selfishness is another man's self reliance; one man's cunning, another's wisdom; one man's greed, another's prudence.

But this reaction was hardly to be expected. None of us can escape the intellectual air we breathe, can fail to be influenced by the values of the community in which we live. As Jews left their closed ghettoes and shtetls and came into contact with the rest of the world, they inevitably came to accept and share the values of that world, the values that looked down on the "merely" commercial, that regarded moneylenders with contempt. They were led to say to themselves: if Jews are like that, the anti-Semites are right.

The other possible reaction is to deny that Jews are like the stereotype, to set out to persuade oneself, and incidentally the anti-Semites, that far from being money-grabbing, selfish and heartless, Jews are really public-

spirited, generous, and concerned with ideals rather than material goods. How better to do so than to attack the market with its reliance on monetary values and impersonal transactions and to glorify the political process, to take as an ideal a state run by well-meaning people for the benefit of their fellow men?

Israel as a Diasporal Reaction

I was first led to this explanation of the anti-capitalist mentality of the Jews by my experience in Israel. After several months there, I came to the conclusion that the quickest way to reach a generalization in any area about values in Israel was to ask what was true of the Jews in the Diaspora and reverse it.

Jews in the Diaspora were urban dwellers engaged in commercial pursuits and almost never in agriculture; in Israel, agriculture has much higher prestige than commerce.

Jews in the Diaspora shunned every aspect of military service; Israelis value the military highly and have demonstrated extraordinary competence.

These two reversals are readily explained as the children of necessity, but let me continue.

Yiddish or Ladino was the language of the Jews in the Diaspora; both are looked down on in Israel, where Hebrew is the language.

Jews in the Diaspora stressed intellectual pursuits and rather looked down on athletics. There is tremendous emphasis on athletics in Israel.

And for what may seem like an irrelevant clincher: Jews in the Diaspora were reputed to be excellent cooks; cooking in Israel is generally terrible, in homes, hotels, and restaurants.

Can this record not be interpreted as an attempt, no doubt wholly subconscious, to demonstrate to the world that the commonly accepted stereotype of the Jews is false?

I interpret in the same way the evidence assembled by James Wilson and Edward Banfield that Jews (and "Yankees") tend to adopt a "community-serving conception" of the public interest, and to vote against their own immediate self-interest, in larger proportions than most other groups.[15]

I interpret also in this way the attempt by Fuchs to trace Jewish "liberalism" to Jewish values and the negative reaction of Jewish critics to Sombart's book. If, like me, you regard competitive capitalism as the economic system that is most favorable to individual freedom, to creative accomplishments in technology and the arts, and to the widest possible opportunities for the ordinary man, then you will regard Sombart's assignment to the Jews of a key role in the development of capitalism as high praise. You will, as I do, regard his book as philo-Semitic. On the other hand, if you are trying your level best to demonstrate that Jews are dedicated to selfless public service in a socialist state, that commerce and money-lending were activities forced on them by their unfortunate circumstances and were wholly foreign to their natural bent, then you will regard Sombart as an anti-Semite simply reinforcing the stereotype against which you are battling. In this vein, the *Universal Jewish Encyclopaedia* says in its article on Sombart: "He *accused* the Jews of having created capitalism" (my italics).

The complementary character of the final two explanations is, I trust, clear. Whence comes the value structure that puts service to the general public above concern for oneself and one's close family; government employment above private business; political activity above commercial activity; love of mankind in general above concern for men in particular; social responsibility above individual responsibility? Very largely from the collectivist trend of thought to which Jews contributed so much for the reasons advanced by Cohn.

Consider, for a moment, the reaction to the anti-Semitic stereotype by a nineteenth-century English Philosophical radical steeped in Benthamite utilitarianism—by a David Ricardo, James Mill, even Thomas Malthus. Could one of them ever have termed the allegation that Jews created capitalism an accusation? They would have termed it high praise. They would have regarded widespread emphasis on rational profit calculation as just what was needed to promote "the greatest good of the greatest number," emphasis on the individual rather than the society as a corollary of belief in freedom, and so on.

I conclude then that the chief explanations for the anti-capitalist mentality of the Jews are

the special circumstances of nineteenth-century Europe which linked pro-market parties with established religions and so drove Jews to the Left, and the subconscious attempts by Jews to demonstrate to themselves and the world the fallacy of the anti-Semitic stereotype. No doubt these two main forces were reinforced, and the view of the Jews altered in detail, by their historical and cultural heritage, which made them specially sensitive to injustice and specially committed to charity. They were reinforced also by whatever the forces are that predispose intellectuals towards the Left.

Whether or not this explanation is a satisfactory resolution of the paradox which was my starting point, it remains true that the ideology of the Jews has been and still is opposed to their self-interest. Except behind the Iron Curtain, this conflict has been mostly potential rather than real. In the West, so long as a large measure of laissez-faire capitalism prevailed, the economic drive of the Jews to improve their lot, to move upward in the economic and social scale, was in no way hindered by the preaching of socialism as an ideal. They could enjoy the luxury of reacting against the anti-Semitic stereotype, yet benefit from the characteristics that that stereotype caricatured. On a much more subtle and sophisticated level, they were in the position of the rich parlor socialists—of all ethnic and religious backgrounds—who bask in self-righteous virtue by condemning capitalism while enjoying the luxuries paid for by their capitalist inheritance.

As the scope of government has grown, as the collectivist ideas have achieved acceptance and affected the structure of society, the conflict has become very real. I have already stressed the conflict in Israel that has led to giving a far greater role to market forces than the ideology of the early leaders envisioned. I have been struck in the United States with the emergence of the conflict in reaction to some of the proposals by Senator George McGovern. His early proposal, later rescinded, to set a top limit on inheritances produced an immediate reaction from some of those who might have been expected to be and were his strongest supporters. It came home to them that his measures—completely consistent with their professed ideology—would greatly hamper the upward social and economic mobility of which they had been the beneficiaries.

Perhaps the reality of the conflict will end or at least weaken the paradox that has been the subject of my talk. If so, it will be a minor silver lining in the dark cloud of encroaching collectivism. □

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1. The only other writer I have come across who explicitly stresses the benefits Jews have derived from capitalism is Ellis Rivkin, *The Shaping of Jewish History* (New York: Scribner's, 1971). Unfortunately, Rivkin's interesting analysis is marred by misconceptions about the nature and operation of capitalism. He takes the accumulation of capital rather than free entry as its distinguishing feature.

2. See for example Hannah Arendt, *The Origins of Totalitarianism* (New York: Harcourt, Brace & Co., 1951), on "court Jews," also Werner Sombart, *The Jews and Modern Capitalism* (London: T. Fisher Unwin, 1913) [translated from 1911 German original].

3. Sombart argues that the relation is the reverse: that capitalism flourished where it did because Jews were given a considerable measure of freedom. But he would not have denied that the relation is reciprocal. And his version has been seriously questioned by economic historians. See Introduction by Bert F. Hoselitz to the American edition of Sombart's book, *Jewish Contributions to Civilization,* 1919, chapter viia, pp. 247-267.

4. See Nathaniel Weyl, *The Creative Elite in America* (Washington, D.C.: Public Affairs Press 1966), particularly the tables in Appendix III giving results for different "elite rosters."

5. For the U.S., see Nathan Glazer, *The Social Basis of American Communism* (New York: Harcourt, Brace and World, Inc., 1961), pp. 85, 130, 132.

6. For the American record, see Werner Cohn, *Sources of American Jewish Liberation—A Study of the Political Alignments of American Jews,* unpublished Ph.D. thesis, New School for Social Research, June 1956; Lawrence Fuchs, *The Political Behavior of American Jews* (Glencoe, Ill.: Free Press, 1956); Nathan Glazer, *American Judaism* (Chicago: University of Chicago Press, 1957); Nathan Glazer and Daniel Patrick Moynihan, *Beyond the Melting Pot* (Cambridge: MIT Press, 2nd ed. 1970).

7. *Op. cit.*, p. 197.

8. *Op. cit.*, pp. 153, 205, 209.

9. *Ibid.*, pp. 216, 221, 222, 248.

10. Nathan Glazer, *American Judaism,* pp. 135, 136, 139.

11. *The Social Basis of American Communism,* pp. 166-167.

12. *Op. cit.*, p. 249.

13. However, according to Abba Eban, "Jews were refused admittance into Massachusetts and Connecticut by the Puritans whose idea of religious liberty was linked to their own brand of faith. However, in liberal Maryland and in Rhode Island, where freedom of conscience was an unshakable principle, they found acceptance." *My People* (New York: Behrman House, Inc., 1968).

14. Jeremy Bentham, *In Defense of Usury* (1787).

15. James Q. Wilson and Edward C. Banfield, "Public-Regardingness as a Value Premise in Voting Behavior," *American Political Science Review,* LVIII, 4 (Dec., 1964), pp. 876-887; "Political Ethos Revisited," *American Political Science Review,* LXV, 4 (Dec., 1971), pp. 1048-1062. The similarity between the Jews and the Yankees in some of the characteristics examined by Wilson and Banfield is some evidence, if rather weak evidence, for the influence of religion and culture in view of the connection between Puritanism and Judaism.

Public Policy Debate: The Rigged Game

by John Semmens

By any measure, the federal government is growing at an alarming rate—the tax burden continues to soar, spending is out of control, and the fiscal 1988 omnibus appropriations bill included an incredible array of special-interest boondoggles. But isn't this what the people want? Haven't they voted for an ever-expanding government? Let us give the matter some thought.

The fact that the last general election saw 98 per cent of the incumbent members of Congress win re-election would appear to substantiate the contention that wastrel government is the will of the people. However, the success rate of incumbent legislators is not necessarily due to voter approval. After all, the success rate of incumbent officers of the Soviet Union's Communist Party is 99 per cent. What's more, their voter turnout ratios are greater. Yet, we'd hardly tout such statistics as a manifestation of an obviously popular government.

This is not to say that American elections are no different from those of more authoritarian systems. At the same time, though, members of the American government do have certain advantages in slanting the public policy debate in favor of their own interests. Private citizens, on the other hand, are handicapped by critical disadvantages even in a society as open to free speech as ours.

Those on the outside of government are handicapped in at least three key ways. First, private citizens often have great difficulty in

acquiring the information needed to wage a successful campaign against government policy. Second, private citizens are at a financial disadvantage in terms of the resources they can apply to the policy debate. Third, private citizens often must do battle on the bureaucrats' home turf.

Consider the matter of information. Proponents of increased government spending have people on the public payrolls working full-time to produce words, numbers, and pictures in support of their cases. Congressmen have extensive staffs to do their bidding. Furthermore, the bureaucracy itself is constantly generating reports, statistics, and presentations on behalf of bigger budgets, more appropriations, and new programs. All of this, of course, is financed out of public funds.

Meanwhile, anyone who would question the need for bloated government programs has tremendous difficulty. After paying taxes to fund the propaganda on behalf of increased government spending, he must find the after-tax resources to fund his contrary views. The facts he

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may need often are buried in the recesses of the bureaucracy. Information is concealed in obscure code-like jargon. Formats peculiar to the public sector obstruct a clear view of the most basic operational information.

Even someone well versed in private-sector accounting can have difficulty deciphering government budget and expenditure reports. Sometimes there is little accounting at all for how public funds are spent. For example, the General Accounting Office (Congress's auditing arm) admitted that 80 per cent of the grants awarded by the Urban Mass Transportation Administration during the Carter Administration were not audited by UMTA. There was no verification of how the money was spent. This information, however, did not receive wide publicity. Subsidies to public transit still amount to billions of dollars each year.

Government employees who may be appalled by the waste they see around them are discouraged from communicating the knowledge to the general public. Complaints through official channels most often are ignored or suppressed. Sanctions and threats of sanctions are used to intimidate any inclination an employee may have to discuss the deficiencies of existing programs or policies. While much hoopla has been made of laws to protect government "whistle-blowers," this protection is granted or withheld at the discretion of Congress. As a major participant in the waste of taxpayers' money, Congress hardly can be expected to be sympathetic to insiders who would expose these schemes to outside scrutiny.

Ignoring Waste

Public hearings on government programs are little more than parades of self-serving supplicants. A few years ago, I appeared at a Senate Appropriations Committee hearing. My objective was to present evidence detailing the egregious waste of one of the multitude of transportation subsidy programs. I was appearing on my own time. My transportation was provided by a privately funded foundation. Mine was the only testimony that day which opposed the subsidies. Arrayed opposite me was a crowd of more than two dozen proponents of continued and expanded subsidies. Virtually every one of these witnesses appeared on behalf of some state or local government agency. The time and transportation of these witnesses were paid for by the same taxpayers from whom future subsidies were to be extracted.

Even when referenda are used to give a greater impression of voter control, the deck is stacked against the private citizen. Public officials call on the vast taxpayer-supported bureaucracy to create the appropriate data in support of the expanded government program. When these partisan undertakings are questioned, the ritualistic defense is that the activities are merely "informational" in character. Of course, the information may have been carefully selected and adjusted to remove any negativism or inconveniently contradictory evidence.

Citizens who oppose increases in taxes or spending must campaign with their own money —what's left of it after taxes. Public law disallows the tax-deductibility of contributions to organizations whose activities are aimed at influencing public policy. The typical public issue controversy, then, sees money taken from the taxpayer to support lobbying for laws designed to take more money from him. Any defense against these raids on his income must be financed with after-tax dollars.

Even after private citizens win a battle against the expansion of government, the war goes on. The restraints achieved by a successful citizens' effort almost always leave a core of the bureaucracy and the big-spending politicians intact. Work begins immediately—at taxpayers' expense—on schemes to evade or reverse any restraints on government power.

New legislation to raise taxes or spending can be introduced at any time. Proposals voted down yesterday can be resurrected today. Sometimes the process is so rigged that a proposal can hardly be resisted, as in the case of local school budgets. If the budget proposal fails, it can be brought up over and over until it passes. Once it passes, the rules change—it cannot be repealed even if the voters change their minds.

The rationalization behind this one-sided procedure is the supposed need to protect public-sector budgeting from the contingencies of the electoral process. Left unstated is the

possibility that the private sector could benefit from being relieved of the uncertainties inherent in repeated attempts to raise taxes. This is especially true for private-sector capital budgeting.

The more routine functions of government appropriations take place when the legislature is in session. The offices of the recipient government agencies are likely to be conveniently located near the legislature. Private-sector businesses and individuals, on the other hand, are dispersed across the nation. It is relatively easy for the public-sector bureaucrat to drop in on legislative hearings to offer support for his agency's budget. It is a lot less convenient for the average citizen to make the trek from home or business to the law-making arena, especially when he must do it on his own time and at his own expense.

Clearly, the claim that the will of the people prevails in government is, at best, an unsubstantiated boast. From a scientific perspective, of course, we cannot rule out the hypothesis that government is operating as the majority of the citizens wish. However, examination of the way the system actually works lends credence to the idea that government may not be closely adhering to the consent of the governed.

The fact that the policy debate game is rigged is cause for concern. But the fact that the proponents of bigger government have to resort to rigging to bolster their chances is also cause for encouragement. The fear that an unrigged game would undo big government is a backhanded validation of the strength of ideas, logic, and integrity. In the long run, such strengths should prevail over the tricks and stratagems of the rigged game. □

The Line-Item Veto Won't Work

by Cecil E. Bohanon and T. Norman Van Cott

Many Americans, including us, are concerned about Federal spending. Except to hardened statists, it is clear that government spending is out of control. This situation prompts many, especially those in conservative circles, to argue that granting Presidents line-item veto authority would restore fiscal sanity. Line-item authority, goes the argument, means Congress could not blackmail Presidents into "supporting" its pork barrel schemes by attaching them to major legislative initiatives. Presidents are alleged to be less beholden to narrow special interests, and armed with a line-item scalpel, they could excise Congressional pandering to these interests.

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The evidence to back up the argument is scanty. Some state governors possess line-item authority, and all recent Presidents have requested it. Line-item advocates offer anecdotes about what particular governors have done. They also fantasize about what various Presidents would have done.

We have no doubt that Harry Truman or Ronald Reagan, for example, might have eliminated some silly spending riders had they possessed the line-item veto. However, this does not persuade us that overall spending would have been lower, for we are equally persuaded

that they would have had a strong incentive to avoid line-item vetoes in exchange for Congressional support for their own "pet" projects.

Bad Facts

The only evidence that would make a convincing case for the veto's efficacy would be data showing that governments which have the veto authority spend less than comparable governments which do not. This would require, of course, that other factors which affect spending be statistically controlled. Per capita government spending in California, for example, probably would be higher than in Mississippi even if California had the veto and Mississippi did not. Before concluding that the line-item veto increases spending, one would have to eliminate statistically the influence of other differences between California and Mississippi.

Fortunately, such a study is not only possible, it has already been done. Burton Abrams of the University of Delaware and William Dougan of Dartmouth College have compared states that allow governors a line-item veto with those that do not.[1] If the line-item veto works as its advocates claim, spending will be less in states where the veto is present, controlling, of course, for other factors. Abrams and Dougan's evidence indicates that the veto has *no* influence on state spending. The implications for the efficacy of a Presidential line-item veto are obvious.

Bad Theory

We are not surprised by these implications. Our nation's fiscal malady can be traced to a more fundamental source than Congressional blackmail. Indeed, the malady was avoided for many decades *without* the line-item veto. Ascribing the problem to the lack of the veto without understanding its root cause is analogous to a blindfolded man's trying to pin the tail on the donkey.

In our view, the malady stems from a change in the implicit "Constitutional ethic" describing the relationship between private economic actions and the government. For the first century or so of our nation's existence, there was a commonly held view which placed most private economic activity outside the domain of government policy. The implication of this ethic is profound. If no one believes that the government is (or should be) the guarantor of income security, government transfer payments do not inflate the budget. If government intervention in private markets is not considered appropriate, agricultural price support programs do not drain the treasury.

Government programs typically focus benefits on the few and spread their costs among the many. This, of course, skews lobbying effort in favor of the special-interest few, making such programs irresistible to politicians. The Founding Fathers were well aware of this and its implications for fiscal excess. Constitutional separation of powers among the three branches of government was intended to make it difficult for special interests to utilize government for their narrow purposes. The ethic placing most economic functions outside the realm of partisan politics reinforced the Constitutional separation of powers.

The New Constitutional Ethic

In the late 1800s this ethic began to erode.[2] Government began interjecting itself into private economic relations. While any single interference might have been considered unimportant, the change in the ethic restricting government was significant. The ability of special interest groups to use government to capture the wealth of others increased. Our nation now finds itself in a situation where government wealth transfers have extended themselves into every nook and cranny of our economic life. Moreover, all social and economic ills, real or imagined, are viewed as a legitimate domain for a new government program. This is the *new* ethic.

The line-item veto does not arrest this process, let alone enable us to regain what we have lost. Regardless of protestations to the contrary, Presidents are political animals, indeed the most successful of the species. All members of the species find serving special-interest constituencies irresistible. This insures their survival. It is line-item proponent Ronald Reagan, for example, who has proposed yet

another Cabinet level bureaucracy—the Department of Veteran Affairs.

In a world where egocentricity is epidemic, line-item advocates are hitching their fiscal reform wagon to the idea that good people will do good things if given the opportunity. The Founding Fathers, knowing the good people-good things link was fragile, opted for a system which limited government's scope. Unfortunately, this wisdom continues to escape us.

It is instructive to note that Jimmy Carter's attempt at fiscal reform collided with the same contradiction. For Carter it was "sunset laws" that would cut the fluff out of government. Continued existence of government agencies and their programs would be put on a scientific basis by requiring their periodic review by informed citizens. Like line-item advocates, Carter failed to understand the power of special interests in a setting where there is effectively no limit on government's scope of activities. That is, the same special interest constituencies responsible for the government initiatives will prevail in any periodic review.

Concluding Comments

The only substantive thing the line-item veto would accomplish is to realign political clout away from Congress to the President. Lobbying efforts would focus on a single political animal rather than 535 of them. The President's ability to reward *his* special interest constituencies would be enhanced while Congress's ability would be diminished.

The expanded scope of government has made the Congressional-Presidential contest a high-stakes game. This is why recent Presidents have clamored for the veto, whereas Martin Van Buren, for example, ignored the issue. That is, it is not a desire by recent Presidents to limit government which explains their requests for line-item authority. Rather, when Federal spending accounts for 20 per cent of GNP, a line-item veto is more valuable to a President than if spending accounted for 5 per cent of GNP. Is it any wonder that Congress wants to continue playing the game by today's rules?

The clamor for the veto has been wrapped in public-spiritedness. The colorful but contemptible spending riders Congress indulges in are only the tip of an iceberg, however. In a sense, the attention the riders generate is unfortunate because they divert attention from the new ethic responsible for the entire Federal iceberg. The evidence about state governors indicates that their line-item veto does not affect state icebergs. Why would Federal experience be any different? □

1. Burton A. Abrams and William R. Dougan, "The Effect of Constitutional Restraints on Governmental Spending," *Public Choice*, (No. 2, 1986).

2. Dwight R. Lee persuasively argues that this erosion coincided with the failure of the judiciary to consistently uphold private property rights and the sanctity of private contracts. See his "Political Economy of the U.S. Constitution," *The Freeman*, February 1987.

IDEAS ON LIBERTY

Power Corrupts

To expect self-denial from men, when they have a majority in their favor and consequently power to gratify themselves, is to disbelieve all history and universal experience.

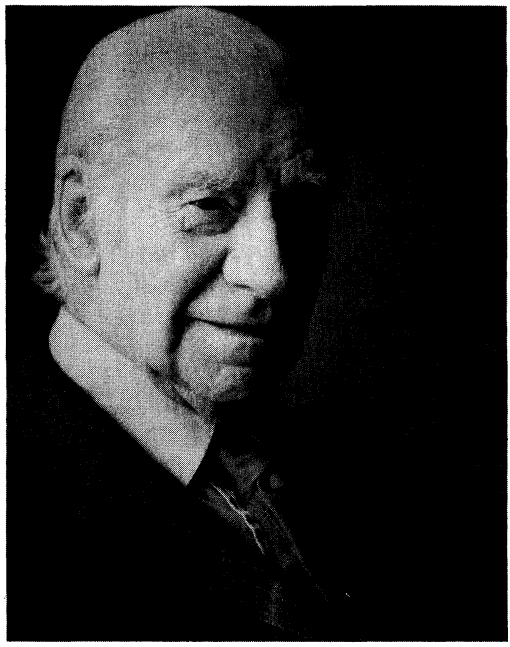
—JOHN ADAMS

William H. Hutt, 1899-1988

by Richard M. Ebeling

In a century that has glorified and tried every variation on the collectivist theme, there has been a handful of dedicated and uncompromising scholars who have resisted the socialist tide. They have defended the market economy, individual liberty, and constitutionally restrained limited government. On June 19, 1988, one of these champions of the free society, Professor William H. Hutt, passed away.

In a career that spanned more than six decades, William Hutt unflinchingly defended the competitive market order against the interventionist schemes of the Keynesian economists, argued against the monopolistic practices of trade unionists that harmed the labor-market choices of the individual worker, warned against regulatory policies that retarded competition and bestowed privileges on a few, and forcefully espoused the classical liberal case for free men and free markets as a solution to the tragedy of state-imposed racism in South Africa.



UNIVERSITY OF DALLAS

William H. Hutt

Born in 1899, Professor Hutt served in the Royal Air Force during the First World War. He then attended the London School of Economics, studying with one of England's greatest liberal economists, Edwin Cannan. After working for the famous English libertarian publisher Sir Ernest Benn in the mid-1920s, Hutt accepted a teaching position at the University of Cape Town in South Africa in 1929. Following his retirement in 1965, he was a visiting professor at several American universities and was Professor Emeritus at the University of Dallas at the time of his death.

For almost three decades following the publication of Keynes' *The General Theory* in 1936, most economists accepted the argument that a market economy was inherently unstable, produced waves of high and prolonged unemployment, and could be saved only by active and aggressive government deficit spending

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and inflation-causing monetary expansion. In several works, *The Theory of Idle Resources* (1939), *Keynesianism—Retrospect and Prospect* (1963), *A Rehabilitation of Say's Law* (1974), and *The Keynesian Episode* (1979), Professor Hutt demolished the foundations of Keynesian thinking. He demonstrated that Keynes failed to understand how a system of competitive and flexible wages and prices assured adjustment and coordination of ever-changing supplies and demands, and that budgetary deficits and monetary expansion produced an illusory prosperity that would retard real adjustment and set the stage for the harmful excesses and economic distortions that always come with inflation and reckless government spending.

At the heart of many of the misunderstandings about the market economy, Professor Hutt maintained, was the false belief that a laissez-faire policy was harmful to the individual working man. That belief was challenged and refuted in his books, *The Theory of Collective Bargaining* (1930; new edition, 1975) and *The Strike-Threat System* (1973). Hutt proved that the greatest opportunity for the material improvement of the individual worker was on an unhampered labor market, upon which employers bid against each other to hire his services and where no barriers were placed in his way as he sought to improve his condition by seeking out the most attractive employment options. Government-supported trade unions could benefit only that minority of workers lucky enough to remain employed after high union wages had priced other workers out of the labor market and onto the unemployment line. Aggressive union power and threats provided privileges for a few at the expense of others.

Hutt also argued that bad economic theory led to bad economic policy. This was the theme in his two works, *Economists and the Public* (1936) and *Politically Impossible . . . ?* (1971). For too long, he insisted, it had not been understood that it was rigid systems of government privilege and favoritism that had maintained conditions of poverty and had led to stark and persistent inequalities of wealth. The market economy was the "great leveler." Established wealth could disappear under the challenge of new and young competitive rivals. Those who were poor could rise to riches if they could devise ways to better satisfy consumers. And all the time, capitalist progress expanded the horizon of choice and broadened the base of prosperity for all. Nothing was politically impossible, in the long run, if sound economic reasoning was not abandoned and if dangerous political compromises were not made along the path of reform and repeal.

The truth is, as I have spent almost my whole academic life in reiterating, the free market is color blind and race blind. When we buy a product, we do not ask, "What was the color of the person who made this?" We ask, "Is this good value for money?"

—W. H. Hutt

An application of his approach to economic theory and policy is given in his masterful study, *The Economics of the Colour Bar* (1964). He traced the history of apartheid in South Africa to the labor-market restrictions of white trade unions and the government barriers to black Africans competing against white businessmen. And he demonstrated that a solution was possible for South Africa through free trade, open labor markets, and protection of individual rights.

In an era in which the most absurd and barbaric ideas have been heralded as brilliant insights in economics, William H. Hutt neither compromised nor toned down the sharp edges of his arguments. But glory is fleeting, and long after the collectivist heralds are forgotten, William Hutt's writings and principled stand will be remembered. □

John D. Rockefeller and the Oil Industry

by Burt Folsom

In 1885, John D. Rockefeller wrote one of his partners, "Let the good work go on. We must ever remember we are refining oil for the poor man and he must have it cheap and good." Or as he put it to another partner: "Hope we can continue to hold out with the best illuminator in the world at the *lowest* price."

Even after 20 years in the oil business, "the best . . . at the lowest price" was still Rockefeller's goal; his Standard Oil Company had already captured 90 per cent of America's oil refining and had pushed the price down from 58 cents to eight cents a gallon. His well-groomed horses delivered blue barrels of oil throughout America's cities and were already symbols of excellence and efficiency. Consumers were not only choosing Standard Oil over that of his competitors; they were also preferring it to coal oil, whale oil, and electricity. Millions of Americans illuminated their homes with Standard Oil for one cent per hour; in doing so, they made Rockefeller the wealthiest man in American history.

Rockefeller's early life hardly seemed the making of a near billionaire. His father was a peddler who often struggled to make ends meet. His mother stayed at home to raise their six children. They moved around upstate New York—from Richford to Moravia to Oswego—and eventually settled in Cleveland, Ohio. John D. was the oldest son. Although he didn't have new suits or a fashionable home, his family life was stable. From his father he learned how to earn money and hold on to it; from his mother he learned to put God first in his life, to be honest, and to help others.

"From the beginning," Rockefeller said, "I was trained to work, to save, and to give." He did all three of these things shortly after he graduated from the Cleveland public high school. He always remembered the "momentous day" in 1855, when he began work at age sixteen as an assistant bookkeeper for 50 cents per day.

On the job Rockefeller had a fixation for honest business. He later said, "I had learned the underlying principles of business as well as many men acquire them by the time they are forty." His first partner, Maurice Clark, said that Rockefeller "was methodical to an extreme, careful as to details and exacting to a fraction. If there was a cent due us he wanted it. If there was a cent due a customer he wanted the customer to have it." Such precision irritated some debtors, but it won him the confidence of many Cleveland businessmen; at age nineteen Rockefeller went into the grain shipping business on Lake Erie and soon began dealing in thousands of dollars.

Rockefeller so enjoyed business that he dreamed about it at night. Where he really felt at ease, though, was with his family and at church. His wife, Laura, was also a strong Christian and they spent many hours a week attending church services, picnics, or socials at the Erie Street Baptist Church. Rockefeller saw a strong spiritual life as crucial to an effective business life. He tithed from his first paycheck

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and gave to his church, a foreign mission, and the poor. He sought Christians as business partners and later as employees. One of his fellow churchmen, Samuel Andrews, was investing in oil refining; and this new frontier appealed to young John. He joined forces with Andrews in 1865 and would apply his same precision and honesty to the booming oil industry.

Discovering Crude Oil

The discovery of large quantities of crude oil in northwest Pennsylvania soon changed the lives of millions of Americans. For centuries, people had known of the existence of crude oil scattered about America and the world. They just didn't know what to do with it. Farmers thought it a nuisance and tried to plow around it; others bottled it and sold it as medicine.

In 1855, Benjamin Silliman, Jr., a professor of chemistry at Yale, analyzed a batch of crude oil. After distilling and purifying it, he found that it yielded kerosene—a better illuminant than the popular whale oil. Other by-products of distilling included lubricating oil, gasoline, and paraffin, which made excellent candles. The only problem was cost: it was too expensive to haul the small deposits of crude from northwest Pennsylvania to markets elsewhere.

Silliman and others, however, formed an oil company and sent "Colonel" Edwin L. Drake, a jovial railroad conductor, to Titusville to drill for oil. "Nonsense," said local skeptics. "You can't pump oil out of the ground as you pump water." Drake had faith that he could; in 1859, when he built a 30-foot derrick and drilled 70 feet into the ground, all the locals scoffed. When he hit oil, however they quickly converted and preached oil drilling as the salvation of the region.

There were few barriers to entering the oil business: drilling equipment cost less than $1,000, and oil land seemed abundant. By the early 1860s, speculators were swarming northwest Pennsylvania, cluttering it with derricks, pipes, tanks, and barrels. "Good news for whales," concluded one newspaper. America had become hooked on kerosene.

Cleveland was a mere hundred miles from the oil region, and Rockefeller was fascinated with the prospects of refining oil into kerosene. He may have visited the region as early as 1862. By 1863 he was talking oil with Samuel Andrews, and two years later they built a refinery together. Two things about the oil industry, however, bothered Rockefeller right from the start: the appalling waste and the fluctuating prices.

The overproducing of oil and the developing of new markets caused the price of oil to fluctuate wildly. In 1862 a barrel (42 gallons) of oil dropped in value from $4.00 to 35 cents. Later, when President Lincoln bought oil to fight the Civil War, the price jumped back to $4.00, then to $13.75. A blacksmith took $200 worth of drilling equipment and drilled a well worth $100,000. Others, with better drills and richer holes, dug four wells worth $200,000. Along side the new millionaires of the moment were the thousands of fortune hunters who came from all over to lease land and kick down shafts into it with cheap foot drills. Most failed. Even Colonel Drake died in poverty. As J. W. Trowbridge wrote, "Almost everybody you meet has been suddenly enriched or suddenly ruined (perhaps both within a short space of time), or knows plenty of people who have."

Those few who struck oil often wasted more than they sold. Thousands of barrels of oil poured into Oil Creek, not into tanks. Local creek bottoms were often flooded with runaway oil; the Allegheny River smelled of oil and glistened with it for many miles toward Pittsburgh. Gushers of wasted oil were bad enough; sometimes a careless smoker would turn a spouting well into a killing inferno. Other wasters would torpedo holes with nitroglycerine, sometimes losing the oil and their lives.

Rockefeller was intrigued with the future of the oil industry, but was repelled by its past. He shunned the drills and derricks and chose the refining end instead. Refining eventually became very costly, but in the 1860s the main supplies were only barrels, a trough, a tank, and a still in which to boil the oil. The yield would usually be about 60 per cent kerosene, 10 per cent gasoline, 5 to 10 per cent benzol or naphtha, with the rest being tar and wastes.

High prices and dreams of quick riches brought many into refining, and this attracted

COURTESY OF ROCKEFELLER ARCHIVE CENTER

The Sexton Building in Cleveland, home of Rockefeller and Andrews, 1865-1867.

Rockefeller, too. But right from the start, he believed that the path to success was to cut waste and produce the best product at the lowest price. Sam Andrews, his partner, worked on getting more kerosene per barrel of crude. Both men searched for uses for the by-products: they used the gasoline for fuel, some of the tars for paving, and shipped the naphtha to gas plants. They also sold lubricating oil, vaseline, and paraffin for making candles. Other Cleveland refiners, by contrast, were wasteful: they dumped their gasoline into the Cuyahoga River, they threw out other by-products, and they spilled oil throughout the city.

In Search of Ways to Save

Rockefeller was constantly looking for ways to save. For example, he built his refineries well and bought no insurance. He also employed his own plumber and almost halved the cost of labor, pipes, and plumbing materials. Coopers charged $2.50 per barrel; Rockefeller cut this to $.96 when he bought his own tracts of white oak timber, his own kilns to dry the wood, and his own wagons and horses to haul it to Cleveland. There with machines he made the barrels, then hooped them, glued them, and painted them blue. Rockefeller and Andrews soon became the largest refiners in Cleveland. In 1870, they reorganized with Rockefeller's brother William, and Henry Flagler, the son of a Presbyterian minister. They renamed their enterprise Standard Oil.

Under Rockefeller's leadership, they plowed the profits into bigger and better equipment. As their volume increased, they hired chemists and developed 300 by-products from each barrel of oil. These ranged from paint and varnish to dozens of lubricating oils to anesthetics. As for the main product, kerosene, Rockefeller made it so cheaply that whale oil, coal oil, and, for a while, electricity lost out in the race to light American homes, factories, and streets. "We had vision," Rockefeller later said. "We saw the vast possibilities of the oil industry, stood at the center of it, and brought our knowledge and imagination and business experience to bear in a dozen, in twenty, in thirty directions."

Another area of savings came from rebates from railroads. The major eastern railroads—the New York Central, the Erie, and the Pennsylvania—all wanted to ship oil and were willing to give discounts, or rebates, to large shippers. These rebates were customary and dated back to the first shipments of oil. As the largest oil refiner in America, Rockefeller was in a good position to save money for himself and for the railroad as well. He promised to ship 60 carloads of oil daily and provide all the loading and unloading services. All the railroads had to do was to ship it east. Commodore Vanderbilt of the New York Central was delighted to give Rockefeller the largest rebate he gave any shipper for the chance to have the most regular, quick, and efficient deliveries. When smaller oil men screamed about rate discrimination, Vanderbilt's spokesmen gladly promised the same rebate to anyone else who would give him the same volume of business. Since no other refiner was as efficient as Rockefeller, no one else got Standard Oil's discount.

Many of Rockefeller's competitors condemned him for receiving such large rebates. But Rockefeller never would have gotten them had he not been the largest shipper of oil. These rebates, on top of his remarkable efficiency, meant that most refiners could not compete. From 1865 to 1870, the price of kerosene dropped from 58 to 26 cents per gallon.

Rockefeller made profits during every one of these years, but most of Cleveland's refiners disappeared. Naturally, there were hard feelings. Henry Demarest Lloyd, whose cousin was an unhappy oil man, wrote *Wealth Against Commonwealth* in 1894 to denounce Rockefeller. Ida Tarbell, whose father was a Pennsylvania oil producer, attacked Rockefeller in a series of articles for *McClure's* magazine.

A Boon for Consumers

Some of the oil producers were unhappy, but American consumers were pleased that Rockefeller was selling cheap oil. Before 1870, only the rich could afford whale oil and candles. The rest had to go to bed early to save money. By the 1870s, with the drop in the price of kerosene, middle and working class people all over the nation could afford the one cent an hour that it cost to light their homes at night. Working and reading became after-dark activities new to most Americans in the 1870s.

Rockefeller quickly learned that he couldn't please everyone by making cheap oil. He pleased no one, though, when he briefly turned to political entrepreneurship in 1872. He joined a pool called the South Improvement Company and it turned out to be one of the biggest mistakes in his life.

The scheme was hatched by Tom Scott of the Pennsylvania Railroad. Scott was nervous about low oil prices and falling railroad rates. He thought that if the large refiners and railroads got together they could artificially fix high prices for themselves. Rockefeller decided to join because he would get not only large rebates, but also drawbacks, which were discounts on that oil which his competitors, not he, shipped. The small producers and refiners bitterly attacked Rockefeller and forced the Pennsylvania Legislature to revoke the charter of the South Improvement Company. No oil was ever shipped under this pool, but Rockefeller got bad publicity from it and later admitted that he had been wrong.

At first, the idea of a pool appealed to Rockefeller because it might stop the glut, the waste, the inefficiency, and the fluctuating prices of oil. The South Improvement Company showed him that this would not work, so he turned to market entrepreneurship instead. He decided to become the biggest and best refiner in the world. First, he put his chemists to work trying to extract even more from each barrel of crude. More important, he tried to integrate Standard Oil vertically and horizontally by getting dozens of other refiners to join him. Rockefeller bought their plants and talent; he gave the owners cash or stock in Standard Oil.

From Rockefeller's standpoint, a few large vertically integrated oil companies could survive and prosper, but dozens of smaller companies could not. Improve or perish was Rockefeller's approach. "We will take your burden," Rockefeller said. "We will utilize your ability; we will give you representation; we will all unite together and build a substantial structure on the basis of cooperation." Many oil men rejected Rockefeller's offer, but dozens of others all over America sold out to Standard Oil.

When they did, Rockefeller simply shut down the inefficient companies and used what he needed from the good ones. Officers Oliver Payne, H. H. Rogers, and President John Archbold came to Standard Oil from these merged firms.

Buying out competitors was a tricky business. Rockefeller's approach was to pay what the property was worth at the time he bought it. Outmoded equipment was worth little, but good personnel and even good will were worth a lot. Rockefeller had a tendency to be generous because he wanted the future good will of his new partners and employees. "He treated everybody fairly," concluded one oil man. "When we sold out he gave us a fair price. Some refiners tried to impose on him and when they found they could not do it, they abused him. I remember one man whose refinery was worth $6,000, or at most $8,000. His friends told him, 'Mr. Rockefeller ought to give you $100,000 for that.' Of course Mr. Rockefeller refused to pay more than the refinery was worth, and the man . . . abused Mr. Rockefeller."

Cutting Costs

Bigness was not Rockefeller's real goal. It was just a means of cutting costs. During the 1870s, the price of kerosene dropped from 26 to eight cents a gallon and Rockefeller captured about 90 per cent of the American market. This percentage remained steady for years. Rockefeller never wanted to oust all of his rivals, just the ones who were wasteful and those who tarnished the whole trade by selling defective oil. "Competitors we must have, we must have," said Rockefeller's partner Charles Pratt. "If we absorb them, be sure it will bring up another."

Just as Rockefeller reached the top, many predicted his demise. During the early 1880s, the entire oil industry was in jeopardy. The Pennsylvania oil fields were running dry and electricity was beginning to compete with lamps for lighting homes. No one knew about the oil fields out West, and few suspected that the gasoline engine would be the power source of the future. Meanwhile, the Russians had begun drilling and selling their abundant oil, and they raced to capture Standard Oil's foreign markets. Some experts predicted the imminent death of the American oil industry; even Standard Oil's loyal officers began selling some of their stock.

Rockefeller's solution to these problems was to stake the future of his company on new oil discoveries near Lima, Ohio. Drillers found oil in this Ohio-Indiana region in 1885, but they could not market it. It had a sulphur base and stank like rotten eggs. Even touching this oil meant a long, soapy bath or social ostracism. No one wanted to sell or buy it and no city even wanted it shipped there. Only Rockefeller seemed interested in it. According to Joseph Seep, chief oil buyer for Standard Oil:

> Mr. Rockefeller went on buying leases in the Lima field in spite of the coolness of the rest of the directors, until he had accumulated more than 40 million barrels of that sulphurous oil in tanks. He must have invested millions of dollars in buying and storing and holding the sour oil for two years, when everyone else thought that it was no good.

Rockefeller had hired two chemists, Herman Frasch and William Burton, to figure out how to purify the oil; he counted on them to make it usable. Rockefeller's partners were skeptical, however, and sought to stanch the flood of money invested in tanks, pipelines, and land in the Lima area. They "held up their hands in holy horror" at Rockefeller's gamble and even outvoted him at a meeting of Standard's Board of Directors. "Very well, gentlemen," said Rockefeller. "At my own personal risk, I will put up the money to care for this product: $2 million–$3 million, if necessary." Rockefeller told what then happened:

> This ended the discussion, and we carried the Board with us and we continued to use the funds of the company in what was regarded as a very hazardous investment of money. But we persevered, and two or three of our practical men stood firmly with me and constantly occupied themselves with the chemists until at last, after millions of dollars had been expended in the tankage and buying the oil and constructing the pipelines and tank cars to draw it away to the markets where we could sell it for fuel, one of our

> German chemists cried "Eureka!" We . . . at last found ourselves able to clarify the oil.

The "worthless" Lima oil that Rockefeller had stockpiled suddenly became valuable; Standard Oil would be able to supply cheap kerosene for years to come. Rockefeller's exploit had come none too soon: the Russians struck oil at Baku, four square miles of the deepest and richest oil land in the world. They hired European experts to help Russia conquer the oil markets of the world. In 1882, the year before Baku oil was first exported, America refined 85 per cent of the world's oil; six years later this dropped to 53 per cent. Since most of Standard's oil was exported, and since Standard accounted for 90 per cent of America's exported oil, the Baku threat had to be met.

The Baku Threat

At first glance, Standard Oil seemed certain to lose. First, the Baku oil was centralized in one small area: this made it economical to drill, refine, and ship from a single location. Second, the Baku oil was more plentiful: its average yield was over 280 barrels per well per day, compared with 4.5 barrels per day from American wells. Third, Baku oil was highly viscous: it made a better lubricant (though not necessarily a better illuminant) than oil in Pennsylvania or Ohio. Fourth, Russia was closer to European and Asian markets: Standard Oil had to bear the costs of building huge tankers and crossing the ocean with them. One independent expert estimated that Russia's costs of oil exporting were one-third to one-half of those of the United States. Finally, Russia and other countries slapped high protective tariffs on American oil; this allowed inefficient foreign drillers to compete with Standard Oil. The Austro-Hungarian empire, for example, imported over half a million barrels of American oil in 1882; but, by 1890 they were buying none. What was worse, local refiners there marketed a low-grade oil in barrels labeled "Standard Oil Company." This allowed the Austro-Hungarians to dump their cheap oil and damage Standard's reputation at the same time.

Rockefeller pulled out all stops to meet the Russian challenge. No small refinery would have had a chance; even a large vertically integrated company like Standard Oil was at a great disadvantage. Rockefeller never lost his vision, though, of conquering the oil markets of the world. First, he relied on his research team to help him out. William Burton, who helped clarify the Lima oil, invented "cracking," a method of heating oil to higher temperatures to get more use of the product out of each barrel. Engineers at Standard Oil helped by perfecting large steamship tankers, which cut down on the costs of shipping oil overseas.

Second, Rockefeller made Standard Oil even more efficient. He used less iron in making barrel hoops and less solder in sealing oil cans. In a classic move, he used the waste (culm) from coal heaps to fuel his refineries; even the sweepings from his factory he sorted through for tin shavings and solder drops.

Third, Rockefeller studied the foreign markets and learned how to beat the Russians in their part of the world. He sent Standard agents into dozens of countries to figure out how to sell oil up the Hwang Ho River in China, along the North Road in India, to the east coast of Sumatra, and to the huts of tribal chieftains in Malaya. He even used spies, often foreign diplomats, to help him sell oil and tell him what the Russians were doing. He used different strategies in different areas. Europeans, for example, wanted to buy kerosene only in small quantities, so Rockefeller supplied tank wagons to sell them oil street by street. As Allan Nevins notes:

> The [foreign] stations were kept in the same beautiful order as in the United States. Everywhere the steel storage tanks, as in America, were protected from fire by proper spacing and excellent fire-fighting apparatus. Everywhere the familiar blue barrels were of the best quality. Everywhere a meticulous neatness was evident. Pumps, buckets, and tools were all clean and under constant inspection, no litter being tolerated. . . . The oil itself was of the best quality. Nothing was left undone, in accordance with Rockefeller's long-standing policy, to make the Standard products and Standard ministrations, abroad as at home, attractive to the customer.

Rockefeller's focus on quality meant that, in an evenly balanced price war with Russia, Standard Oil would win.

The Russian-American oil war was hotly contested for almost 30 years after 1885. In most markets, Standard's known reliability would prevail, if it could just get its price close to that of the Russians. In some years this meant that Rockefeller had to sell oil for 5.2 cents a gallon—leaving almost no profit margin—if he hoped to win the world. This he did; and Standard often captured two-thirds of the world's oil trade from 1882 to 1891 and a somewhat smaller portion in the decade after this.

Rockefeller and his partners always knew that their victory was a narrow triumph of efficiency over superior natural advantages. "If," as John Archbold said in 1899, "there had been as prompt and energetic action on the part of the Russian oil industry as was taken by the Standard Oil Company, the Russians would have dominated many of the world markets. . . ."

At one level, Standard's ability to sell oil at close to a nickel a gallon meant hundreds of thousands of jobs for Americans in general and Standard Oil in particular. Rockefeller's margin of victory in this competition was always narrow. Even a rise of one cent a gallon would have cost Rockefeller much of his foreign market. A rise of three cents a gallon would have cost Rockefeller his American markets as well.

At another level, oil at little more than a nickel a gallon opened new possibilities for people around the world. William H. Libby, Standard's foreign agent, saw this change and marveled at it. To the governor general of India he said:

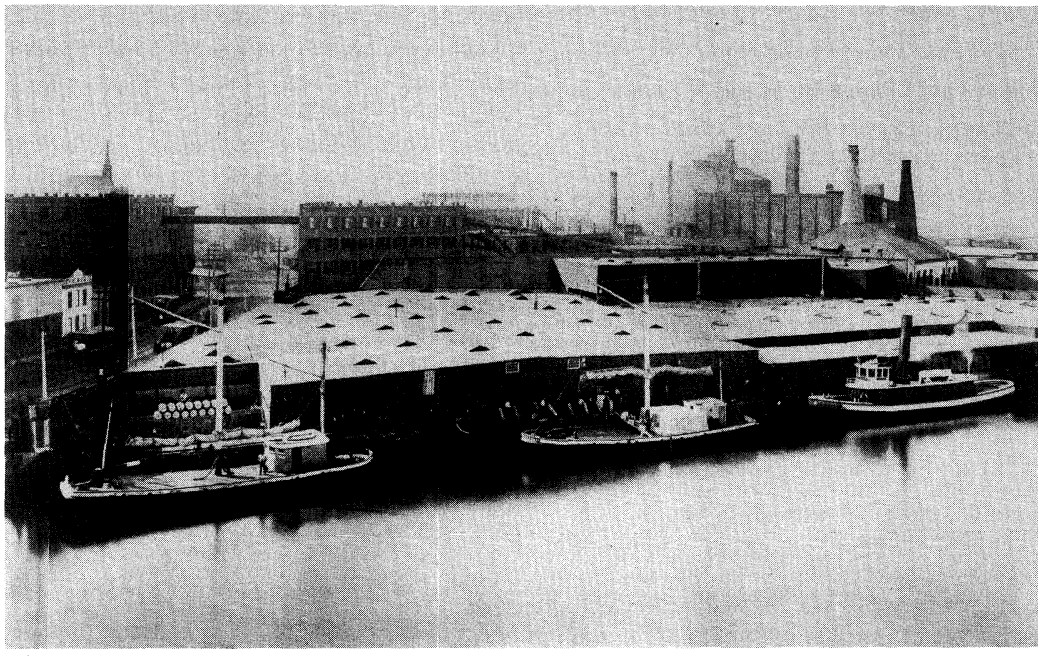
> I may claim for petroleum that it is something of a civilizer, as promoting among the poorest classes of these countries a host of evening occupations, industrial, educational, and recreative, not feasible prior to its introduction; and if it has brought a fair reward to the capital ventured in its development, it has also carried more cheap comfort into more poor homes than almost any discovery of modern times.

In Standard Oil, Rockefeller arguably built the most successful business in American history. In running it, he showed the precision of a bookkeeper and the imagination of an entrepreneur. Yet, in day-to-day operations, he led quietly and inspired loyalty by example. Rockefeller displayed none of the tantrums of a Vanderbilt or a Hill, and none of the flamboyance of a Schwab. At board meetings, he would sit and patiently listen to all arguments. He would often say nothing until the end. But his fellow directors all testified to his genius for sorting out the relevent details and pushing the right decision, even when it was shockingly bold and unpopular. "You ask me what makes Rockefeller the unquestioned leader in our group," said John Archbold, later a president of Standard Oil. "Well, it is simple. In business we all try to look ahead as far as possible. Some of us think we are pretty able. But Rockefeller always sees a little further ahead than any of us—and then he sees around the corner."

Some of these peeks around the corner helped Rockefeller pick the right people for the right jobs. He had to delegate a great deal of responsibility, and he always gave credit—and sometimes large bonuses—for work well done. Paying higher than market wages was Rockefeller's controversial policy: he believed it helped slash costs in the long run. For example, Standard was rarely hurt by strikes or labor unrest. Also, he could recruit and keep the top talent and command their future loyalty.

"The Standard Oil Family"

Rockefeller approached the ideal of the "Standard Oil family" and tried to get each member to work for the good of the whole. As Thomas Wheeler said, "He managed somehow to get everybody interested in saving, in cutting out a detail here and there. . . ." He sometimes joined the men in their work and urged them on. At 6:30 in the morning there was Rockefeller "rolling barrels, piling hoops, and wheeling out shavings." In the oil fields, there was Rockefeller trying to fit nine barrels on a eight-barrel wagon. He came to know the oil business inside out and won the respect of his workers. Praise he would give; rebukes he would avoid. "Very well kept—very indeed,"



COURTESY OF THE ROCKEFELLER ARCHIVE CENTER

Devoe's Brilliant Oil Works, Long Island City, New York, where the "drop of solder" was saved.

said Rockefeller to an accountant about his books before pointing out a minor error and leaving. One time a new accountant moved into a room where Rockefeller kept an exercise machine. Not knowing what Rockefeller looked like, the accountant saw him and ordered him to remove it. "All right," said Rockefeller, and he politely took it away. Later, when the embarrassed accountant found out whom he had chided, he expected to be fired; but Rockefeller never mentioned it.

Rockefeller treated his top managers as conquering heroes and gave them praise, rest, and comfort. He knew that good ideas were almost priceless: they were the foundation for the future of Standard Oil. To one of his oil buyers, Rockefeller wrote, "I trust you will not worry about the business. Your health is more important to you and to us than the business." Long vacations at full pay were Rockefeller's antidotes for his weary leaders. After Johnson N. Camden consolidated the West Virginia and Maryland refineries for Standard Oil, Rockefeller said, "Please feel at perfect liberty to break away three, six, nine, twelve, fifteen months, more or less. . . . Your salary will not cease, however long you decide to remain away from business." But neither Camden nor the others rested long. They were too anxious to succeed in what they were doing and to please the leader who trusted them so. Thomas Wheeler, an oil buyer for Rockefeller said, "I have never heard of his equal in getting together a lot of the very best men in one team and inspiring each man to do his best for the enterprise."

Praise from Others

Not just Rockefeller's managers, but his fellow entrepreneurs thought he was remarkable. In 1873, the prescient Commodore Vanderbilt said, "That Rockefeller! He will be the richest man in the country." Twenty years later, Charles Schwab learned of Rockefeller's versatility when Rockefeller invested almost $40 million in the controversial ore of the Mesabi iron range near the Great Lakes. Schwab said, "Our experts in the Carnegie Company did not believe in the Mesabi ore fields. They thought the ore was poor. . . . They ridiculed Rockefeller's investments in the Mesabi." But by 1901, Carnegie, Schwab, and J. P. Morgan had changed their minds and offered Rockefeller almost $90 million for his ore investments.

As I study wealthy men, I can see but one way in which they can secure a real equivalent for money spent, and that is to cultivate a taste for giving when the money will produce an effect which will be a lasting gratification.

—John D. Rockefeller

That Rockefeller was a genius is widely admitted. What is puzzling is his philosophy of life. He was a practicing Christian and believed in doing what the Bible said to do. Therefore, he organized his life in the following way: he put God first, his family second, and career third. This is the puzzle: how could someone put his career third and wind up with $900 million, which made him the wealthiest man in American history. This is not something that can be easily explained (at least not by conventional historical methods), but it can be studied.

"Spiritual Food"

Rockefeller always said that the best things he had done in life were to make Jesus his Saviour and to make Laura Spelman his wife. He prayed daily the first thing in the morning and went to church for prayer meetings with his family at least twice a week. He often said he felt most at home in church and in regular need of "spiritual food"; he and his wife also taught Bible classes and had ministers and evangelists regularly in their home.

Going to church, of course, is not necessarily a sign of a practicing Christian. Ivan the Terrible regularly prayed and went to church before and after torturing and killing his fellowmen. Even Commodore Vanderbilt sang hymns out of one side of his mouth and out of the other spewed a stream of obscenities.

Rockefeller, by contrast, read the Bible and tried to practice its teachings in his everyday life. Therefore, he tithed, rested on the Sabbath, and gave valuable time to his family. This made his life hard to understand for his fellow businessmen. But it explains why he sometimes gave tens of thousands of dollars to Christian groups, while at the same time, he was trying to borrow over a million dollars to expand his business. It explains why he rested on Sunday, even as the Russians were mobilizing to knock him out of European markets. It explains why he calmly rocked his daughter to sleep at night, even though oil prices may have dropped to an all-time low that day. Others panicked, but Rockefeller believed that God would pull him through if only he would follow His commandments. He worked to the best of his ability, then turned his problems over to God and tried not to worry. This is what he often said:

> Early I learned to work and to play.
> I dropped the worry on the way.
> God was good to me every day.

Those who heard him say this may have thought he was mouthing platitudes, but the key to understanding Rockefeller is to recognize that he said it because he believed it.

When the Russians sold their oil in Standard's blue barrels, Rockefeller did not get into strife. He knew that the book of James said, "For where envying and strife is, there is confusion and every evil work." He fought the Russians, using his spies and his authority to stop them and outsell them; but he never slandered them or threatened them. No matter what, Rockefeller never lost his temper, either. This was one of the remarkable findings of Allan Nevins in his meticulous research on Rockefeller. During the 1930s, Nevins interviewed dozens of people who worked with Rockefeller and knew him intimately. Not one —son, daughter, friend, or foe—could ever recall Rockefeller losing his temper or even being perturbed. He was always calm.

The most famous example is the time Judge K. M. Landis fined Standard Oil of Indiana over $29 million. The charge was taking rebates; and Landis, an advocate of government intervention, publicly read the verdict of "guilty" for Standard Oil. *Railway World* was shocked that "Standard Oil Company of Indiana was fined an amount equal to seven or

eight times the value of its entire property because its traffic department did not verify the statement of the Alton rate clerk that the six-cent commodity rate on oil had been properly filed with the Interstate Commerce Commission." The *New York Times* called this decision a bad law and "a manifestation of that spirit of vindictive savagery toward corporations. . . ." But Rockefeller, who had testified at the trial, was unruffled.

On the day of the verdict, he chose to play golf with friends. In the middle of their game, a frantic messenger came running through the fairways to deliver the bad news to Rockefeller. He calmly looked at the telegram, put it away, and said, "Well, shall we go on, gentlemen?" Then he hit his ball a convincing 160 yards. At the next hole, someone sheepishly asked Rockefeller, "How much is it?" Rockefeller said, "Twenty-nine million two hundred forty thousand dollars," and added, "the maximum penalty, I believe. Will you gentlemen drive?" He ended the nine holes with a respectable score of 53, as though he hadn't a care in the world.

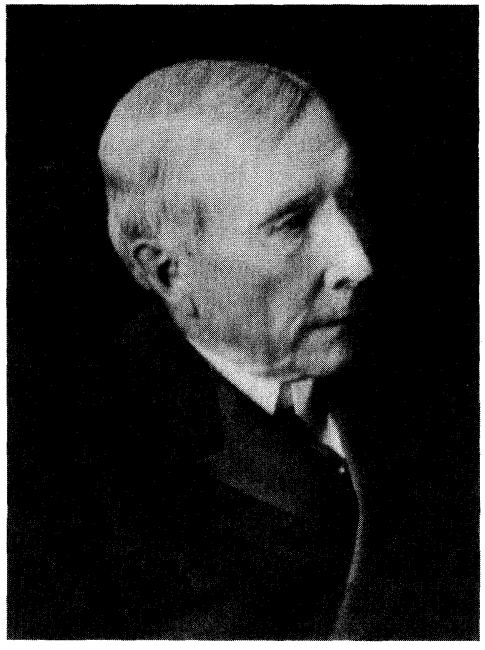
Landis's decision was eventually overruled, but Rockefeller was not so lucky in his fight against the Sherman Antitrust Act. Rockefeller had set up a trust system at Standard Oil merely to allow his many oil businesses in different states to be headed by the same board of directors. Some states, like Pennsylvania, had laws permitting it to tax all of the property of any corporation located within state borders. Under these conditions, Rockefeller found it convenient to establish separate Standard Oil corporations in many different states, but have them directed in harmony, or in trust, by the same group of men. The Supreme Court struck this system down in 1911 and forced Standard Oil to break up into separate state companies with separate boards of directors.

This decision was puzzling to Rockefeller and his supporters. The Sherman Act was supposed to prevent monopolies and those companies "in restraint of trade." Yet Standard Oil had no monopoly and certainly was not restraining trade. The Russians, with the help of their government, had been gaining ground on Standard in the international oil trade. In America, competition in the oil industry was more intense than ever. Over 100 oil companies—from Gulf Oil in Texas to Associated Oil in California—competed with Standard. Standard's share of the United States and world markets had been steadily declining from 1900 to 1910. Rockefeller, however, took the decision calmly and promised to obey it.

Even more remarkable than Rockefeller's serenity was his diligence in tithing. From the time of his first job, where he earned 50 cents a day, the 16-year old Rockefeller gave to his local Baptist church, to missions in New York City and abroad, and to the poor—black or white. As his salary increased, so did his giving. By the time he was 45 he was up to $100,000 per year; at age 53, he topped the $1,000,000 mark in his annual giving. His eightieth year was his most generous: $138,000,000 he happily gave away.

The more he earned the more he gave, and the more he gave the more he earned. To Rockefeller, it was the true fulfillment of the Biblical law: "Give, and it shall be given unto you; good measure, pressed down, and shaken together, and running over, shall men give into your bosom." Not "money" itself but "the love of money" was "the root of all evil." And Rockefeller loved God much more than his money. He learned what the prophet Malachi meant when he said, "Bring the whole tithe into the storehouse . . . and see if I will not throw open the floodgates of heaven and pour out so much blessing that you will not have room enough for it." He learned what Jesus meant when he said, "With the measure you use, it will be measured to you." So when Rockefeller proclaimed: "God gave me my money," he did so in humility and in awe of the way he believed God worked.

Some historians haven't liked the way Rockefeller made his money, but few have quibbled with the way he spent it. Before he died, he had given away about $550,000,000, more than any other American before him had ever possessed. It wasn't so much the amount that he gave as it was the amazing results that his giving produced. At one level he built schools and churches and supported evangelists and missionaries all over the world. After all, Jesus said, "Go ye into all the world, and preach the gospel to every creature."



Courtesy Library of Congress

John D. Rockefeller
1839-1937

Healing the sick and feeding the poor was also part of Rockefeller's Christian mission. Not state aid, but Rockefeller philanthropy, paid teams of scientists who found cures for yellow fever, meningitis, and hookworm. The boll weevil was also a Rockefeller target, and the aid he gave in fighting it improved farming throughout the South.

Seeking Solutions to Social and Medical Problems

Rockefeller attacked social and medical problems the same way he competed against the Russians—with efficiency and innovation. To get both of these, Rockefeller gave scores of millions of dollars to higher education. The University of Chicago alone got over $35,000,000. Black schools, Southern schools, and Baptist schools also reaped what Rockefeller had sown. His guide for giving was a variation of the Biblical principle—"If any would not work, neither should he eat." Those schools, cities, or scientists who weren't anxious to produce or improve didn't get Rockefeller money. Those who did and showed results got more. As in the parable of the talents, to him who has, more (responsibility and trust) shall be given by the Rockefeller Foundation.

At about the age of 60, Rockefeller began to wind down his remarkable business career to focus more on philanthropy, his family, and leisure. He took up gardening, started riding more on his horses, and began playing golf. Yale University might ban the tango, but Rockefeller hired an instructor to teach him how to do it. Even in recreation, Rockefeller wanted to discipline his actions for the best result. In golf, he hired a caddy to say "Hold your head down," before each of his swings. He even strapped his left foot down with croquet wickets to keep it steady during his drives.

In a way, Rockefeller's life was a paradox. He was fascinated with human nature and enjoyed studying people. Yet his unparalleled success in business made friendships awkward and forced him to shut out much of the world. To his children Rockefeller was the man who played blind man's buff with great gusto, balanced dinner plates on his nose, and taught them how to swim and to ride bicycles. But from the world he had to keep his distance: he was a target for fortune hunters, fawners, chiselers, and mountebank preachers. Hundreds of hard-luck letters were written to him each week.

Retirement, however, liberated him more to enjoy people and nature. On his estate in New York, he studied plants and flowers. Sometimes he would drive out into the countryside just to admire a wheat field. Down in Florida, he liked to watch all the people who passed his house and guess at what they did in life. He handed out dimes to neighborhood children and urged them to work and to save.

Naturally, Rockefeller had some disappointments in his last years. He was sad that Standard Oil had been broken up by the Sherman Act and that the Russians had increased their foreign oil sales. He also was saddened by the Great Depression of the 1930s. Still, Rockefeller knew he had lived a full life and had been a key part of the two big transformations in the oil industry: the making of kerosene for lighting homes and the making of gasoline for running cars. Rockefeller loved life and wanted to live to be one-hundred, but he died in his sleep during his ninety-eighth year in 1937. □

A REVIEWER'S NOTEBOOK

The Myth of the Common School

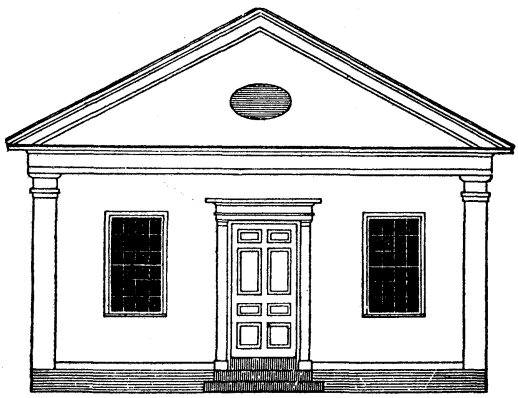
by John Chamberlain

Charles Leslie Glenn, Jr., in his *The Myth of the Common School* (The University of Massachusetts Press, Amherst, Massachusetts, 369 pp., $37.50 cloth, $13.95 paper), does not use the word "myth" in its ordinary sense as implying something that is untrue. He uses it as a synonym for "idea."

The "common," or State-funded, school does not have a hoary ancestry. It is a product more or less of nineteenth-century thinking. Before the French Revolution, private church-connected schools were the norm in most of the Western world.

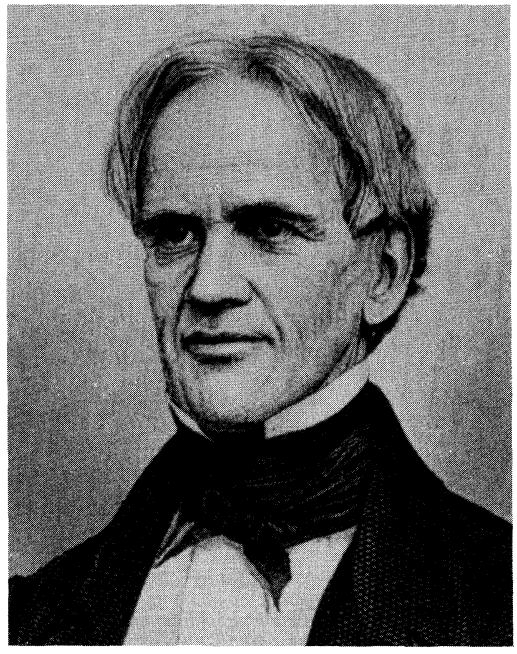
It was in Jacobin France in the 1790s that the idea that children belonged to the State found its first acceptance. Rousseau preached that doctrine. Education in Rousseau's thinking should be devoted not only to reading, writing, and calculating but to teaching the child that his life should be led in accordance with the "general will." This was "hard" doctrine, and, since most teachers in revolutionary France were nuns, the Jacobins had the problem of teacher training to surmount. It remained for François Guizot, in the early days of the "liberal" regime established in 1830, to make the State school a real solid thing.

How did the idea of the common school get to the Massachusetts of Horace Mann, who, as the twelve-year secretary of the State Board of Education, made it a personal crusade to establish it as the American norm? As Mr. Glenn tells it, there was a round-aboutness to the percolation of the idea in America. In France, the development of the common school was sparked by a growing anti-clericalism, which had no appeal to a predominantly liberal Protestant United States. But in the Netherlands what Glenn describes as a "soft form" public school agenda emerged in the early Eighteen Hundreds. The two De Groots, father and son, pushed the "soft form" and defended it against both Catholics and extreme Protestants who wanted their own schools. The younger De Groot happened to be the biographer of William Ellery Channing, the Boston Unitarian minister who helped persuade Horace Mann to take on what Glenn calls the "intellectual and moral improvement" of future citizens.



District school, Monroe, Michigan, c. 1848.

Religion has been the stumbling block in the common school thinking of most Western countries. Mann evaded the block by generalizing the religion he professed to a vague goodness of heart. He visited Prussian and Dutch schools on a memorable trip to Europe in 1843 and was convinced that an American common school could be Christian without sectarian



Horace Mann
1796-1859

overtones. The Bible could be read in school in a way that would let it speak for itself. Prayer need not be denominational. But religion was pretty much of a second thought with Horace Mann. He wanted his school to be a nationalist bastion, with the students carrying a common image of their country in their minds. They would read the same classics and accept the Constitution of the Founding Fathers.

Pragmatically considered, Horace Mann's common school was just the thing for Massachusetts in the mid-nineteenth century. Immigrants were pouring in from Ireland and other European countries. They could not have been Americanized by a score of sectarian church schools. Even with immigrants who understood English there were nuances that would have continued to escape them if they hadn't been compelled to attend the common school.

The time-and-place justification for the common school in Mann's Massachusetts, however, cannot be universalized. It has not stood up in the France of the Fifth Republic. In the Netherlands, despite the De Groots, parent choice is now the basic organizing principle of education. And in the United States the private school is now flourishing.

Glenn is equivocal on the subject of the "democracy" of a public school system. Obviously, there is no voluntarism to it when parents are forced to accept it and when the truant officer is part of the town payroll. In Horace Mann's day there was a broad consensus about the aims of education. "The difference," says Glenn, "is that in Horace Mann's day, the moral objectives of the school were essentially congruent with those of the public, but this is no longer the case. Mann drew upon a consensus about right and wrong, that as he often pointed out, was largely independent of the diverse religious convictions of the times. Those who rejected the public schools did so on theological grounds that, except when reinforced by a strong identification with an immigrant church, were of secondary importance. For most parents, as Tocqueville found, sectarian differences in a common Protestant Christianity were cheerfully accepted."

The consensus on the moral content of education, so Glenn says, no longer exists. But Glenn cannot bring himself to say that the public school must go. He is a pluralist, a believer in the value of diversification, and accepts the competition between public and private education as beneficial. He suggests, in a somewhat enigmatic conclusion, that stressing parents' choice should not preclude "working with the utmost care to develop a diversity of schooling that offers distinctive approaches to the common goals of our society." Then, he says, "we can rebuild broad support for public education."

This is hardly a rousing conclusion. If the common goal of Western societies is to escape from the clutches of socialism, as it should be, it is not helpful to ask that our children should become compulsory wards of the State.

Separating School and State

Leonard Read once said the separation of State and school is just as important as the separation of State and church. I remember saying to him, yes, but such separation won't come in my lifetime. One is permitted, however, to cherish some ultimate ends. One such end is that education, some day, will become a matter for universal private choice. □

THE SUPREME COURT'S CONSTITUTION: AN INQUIRY INTO JUDICIAL REVIEW AND ITS IMPACT ON SOCIETY

by Bernard H. Siegan

Transaction Books, Rutgers University, New Brunswick, NJ 08903 • 1987 • 215 pages • $29.95 cloth, $14.95 paperback

Reviewed by Robert W. McGee

Bernard Siegan has written a number of books dealing with economic regulation and the tension between government and the individual, such as *Economic Liberties and the Constitution, Land Use Without Zoning,* and *Other People's Property,* and has edited several books on law and economics. President Reagan nominated him for a judgeship on the Ninth Circuit Court of Appeals. Libertarian Presidential candidate Ron Paul would like to nominate him to the Supreme Court.

His latest book, *The Supreme Court's Constitution,* is in the tradition of Richard Epstein and Stephen Macedo—and Thomas Jefferson, for that matter. The theme of the book is that the Supreme Court has strayed from the original intent of the Founding Fathers, and over the last 200 years has systematically usurped legislative power. Congress is supposed to make Federal laws, yet that function increasingly has been taken over by the Supreme Court.

Various Supreme Court justices, over the past 200 years, have found political rights that are not explicitly protected in the Constitution, and have denied economic rights that the Constitution is supposed to defend. Over the years, the Court has ranked political liberties above economic liberties, without recognizing that political and economic liberties are two sides of the same coin—individual liberty. The Court has consistently failed to look at the founders' original intent, and instead rendered decisions based on sociological theory, an approach that weakens the rule of law:

> . . . The Court would find it most difficult if not impossible to prove that a majority of the persons responsible for framing the relevant sections of the Constitution provided authority for major rulings the Court has imposed. A great many in the society have been affected both favorably and unfavorably; rights and powers have been created for some and denied or withdrawn from others, depending on the composition of a majority of the Court at a particular time. Such practices erode the rule of law, at the root of constitutional government.

The book is not easy reading, not because Siegan's style is unclear, but because of the nature of the subject. It is difficult to write about complex constitutional theory in terms that a nonprofessional can understand. But Siegan does a good job of stating his case without watering down the content of what he is saying. The book is scholarly and nonpolemical. In fact, in some cases it is difficult to determine what Siegan's position is because of the historical approach he takes. One chapter was partly taken from one of his law review articles. Each of the eight substantive chapters contains between 30 and 160 footnotes. Readers who want to delve deeper into one of Siegan's topics can use these footnotes to advantage. The index is also quite good for those who want to find quickly what he has to say on a particular subject.

Of the many constitutional topics that could be analyzed, Siegan chooses eight as representative of how the Court has strayed from the Founding Fathers' original intent: federalism, implied powers, and the necessary and proper clause; paper money and legal tender; economic and property rights; classification on the basis of race; the establishment of religion clause; gender; abortion and sexual privacy; and the first amendment and libel. In each case, he establishes the founders' original intent, and shows how each area has evolved over the last two centuries. In many cases, original intent has been ignored by the Court. A number of times, the Court's view on a particular topic has reversed 180 degrees as the Court's membership changed, a development which is disturbing to those who think society should be guided by the rule of law and not the rule of men.

The chapter on federalism, implied powers, and the necessary and proper clause discusses

what went on at the Constitutional Convention and the effect Hamilton and Madison had on the final wording of the Constitution. Some early court decisions also are discussed, most notably the constitutionality of establishing a national bank. The chapter on paper money and legal tender outlines the founders' position on paper money (they were against it) and how a series of decisions expanded the federal government's authority to issue paper currency in whatever quantities it saw fit. The result is that the federal government can cause the very inflation the founding fathers sought to avoid.

Siegan says that the Court has relegated economic liberty to a position of low priority over the last four decades, but I would posit that economic liberties were accorded second place status much earlier than that. Any cut-off date, of course, is arbitrary. The Court now presumes that a law restricting economic liberty is constitutional, and it is the aggrieved party's burden to overcome that presumption. Siegan reviews some of the more prominent cases in the area of economic regulation.

The Civil Rights Acts have been interpreted over the years to mean something very different from what the drafters intended. The equal protection clause of the 14th Amendment has been twisted and turned in so many directions that it now means whatever any five Supreme Court justices say it means. A wall has been constructed by the Court separating church from State, although there is no evidence to suggest that the founders intended any such wall to be erected. The Court has become legislator in gender cases, especially since 1971. Abortion cases were decided on the basis of the individual justices' personal views, and legal theories were found to support those views rather than to form them. Since 1964, the Court has tended to decide libel and First Amendment cases on a sociological basis rather than attempting to determine the intent of the framers.

Siegan shows a consistent pattern in eight constitutional areas which makes it easy for the reader to see that failure to consider original intent has resulted in a weakening of the Constitution and the rule of law:

> . . . Justice demands the rule of law and not of individuals. By comparision, those who refuse to be bound "by the hand of the past" confront the troublesome question of how much discretion courts should have in departing from the document's original meaning. Because no absolute answer to this question exists, omitting the restraint of strict construction accords immense authority to five of nine people who, at any one time, happen to occupy the highest judicial seats of power. They would then have unlimited power to define contemporary values and concerns, an exercise that is highly subjective. □

(*Professor McGee holds a law degree and teaches accounting at Seton Hall University.*)

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THE FREEMAN
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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Thomas C. Stevens, chairman; Ridgway K. Foley, Jr., vice-chairman; Paul L. Poirot, secretary; H.F. Langenberg, treasurer.

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Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

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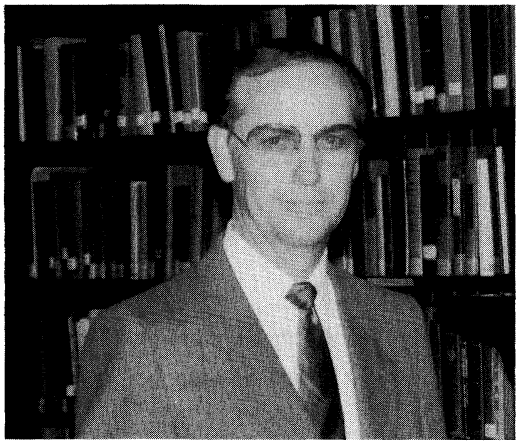
PERSPECTIVE



Bruce M. Evans

Remembering Who We Are

The election of national leaders brings forth feelings of anxiety and expectancy. Yet, change often carries a glimmer of hope, even in the minds of hardened realists or confirmed skeptics.

Somehow, coming off a season of defeats, a football team retains a spark of optimism that its first game can be won. Similarly, we often feel a new year will be better than the last—or a new can of coffee offers a better aroma. It may even be possible that a new President will be better than the last one.

Americans are harsh judges of political figures. Our feelings are a curious mixture of high hopes and not-so-high expectations.

We hope for a return to personal initiative and responsibility, but we expect a continuation of current welfare state policies. We hope for a return to reason and logic in meeting problems of natural resources and economic policy, but we expect that special interest groups will continue to hold sway. Thus, we are frequently the schizophrenic victims of hope and despair.

Many of us had parents who said to us in some way as we prepared to leave home: "Remember who you are." And I want to suggest that here: Remember who you are.

Free people have been characterized throughout history by initiative, courage, independence, and compassion—all of which contribute to a better quality of life. Traditionally, free people ask only for an opportunity.

Elected officials in America once were seen as people of character, integrity, principles, and good judgment—chosen to protect the interests of all the people. It was understood that special interest issues were not to be settled by governmental intervention, but through peaceful interactions in the market.

We need leaders who will help us understand that if we try to advance our vested, selfish interests through political means, we will restrict our own freedom, as well as that of our fellowmen.

Edmund Burke once said: "The great difference between the real statesman and the pretender is that one sees into the future, while the other regards only the present; the one lives by the day, and acts on expediency; the other acts on enduring principles and for immortality."

If there were fewer calls for expediency and political intervention, there would be far less of the same. Much of the regulation which we find so offensive is brought on by the abuse of influence and by special request. Group after group is organized to secure more money or advantage through government intervention.

In his address urging adoption of the United States Constitution, Benjamin Franklin stated: ". . . I cannot help expressing a wish that every member . . . would doubt a little of his own infallibility."

Let us ask our officials to recall their own fallibility. Let us ask them to remember that the constitutional purposes of government pertain to the protection of life, liberty, and property, and to leave our personal and social problems to individual and community initiatives.

Whether one's perspective is optimistic or pessimistic, we should note with Emerson that "This time, like all times, is a very good one, if we but know what to do with it."

Let us use it well!

—BRUCE M. EVANS
President

Civilization

The Declaration of Independence lists "the pursuit of happiness" as among the most fundamental of rights. In this the framers were realists, rather than moralists.

Civilization has greatly advanced in material wealth and its intellectual underpinnings: steadily, clearly, and progressively the standard of living has risen and the proportion of total output devoted to life's necessities has fallen. Indeed, in many cases, today's understanding of a necessity was yesterday's understanding of a luxury.

Moralists may prefer to think of civilization as progress in "the pursuit of virtue," but evidence for this is scanty. Violence, coercion, and fraud flourish everywhere, even in the most "civilized" and "advanced" countries. Nor are crimes and sins of man against man less abundant now than in yesteryear.

"Civilized," literally, means "fit for life in cities." And indeed it is the cities that are most vibrant economically and intellectually, centers of commerce and know-how, filled with trade and economic and intellectual specialization and cooperation. As Jefferson described the "march of civilization"— "like a cloud of light, increasing our knowledge and improving our condition."

But as Jefferson so often predicted, cities are also among the places least given to virtue and most given to vice, with violence done to persons and property everywhere in sight.

What does this mean to those of us devoted to the freedom philosophy? It means that while the pursuit of happiness, and the economic and intellectual progress that makes it possible, are aided greatly by the cooperation, competition, and specialization of the marketplace, the pursuit of virtue is intrinsically a matter of individual effort dedicated to self-improvement. This the Founders understood.

—JOSEPH S. FULDA

THE FREEMAN
IDEAS ON LIBERTY

The Pilgrims in Holland

by Robert A. Peterson

The Dutch have given many things to America: Easter eggs, Santa Claus, waffles, sauerkraut, sleighing, skating, and a host of "vans" and "velts" who helped to build our nation.[1] But perhaps their greatest contribution to America was the 11 years of freedom they gave the Pilgrims—crucial years that helped America's founding fathers work out their philosophy of freedom and prepare for self-government in the New World.

The story of Holland's rise due to free market policies has already been sketched in a previous *Freeman* article.[2] Suffice to say that her struggle for independence from Spain was of epic proportions: when, after a siege of several months, the citizens of Leyden talked of surrender, one burgomaster fortified their spirits by saying, "Here is my sword; plunge it, if you will, into my heart, and divide my flesh among you to appease your hunger; but expect no surrender as long as I am alive."[3] The burgomaster lived—and so did the rest of the citizens of Leyden—to see the day when William the Silent routed the besieging Spaniards. The defense of Leyden turned the tide, and from then on the Dutch never looked back in their fight for freedom. Once they were free, the Dutch embraced much of what we would call a free market philosophy and set up a limited government. In the early 1600s, Holland was the most liberal society in Europe.

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It should not surprise us, then, that when English Separatists began to think of emigrating, they thought of Holland. But emigrating to Holland would be no easy task: Englishmen could not leave the country without permission. Never mind—the Separatists would leave secretly. The first group—members of a Brownist church in Gainsborough, went over in 1607; hearing good reports, members of the Scrooby congregation—the group which included many of the Pilgrim Fathers—prepared to follow. After several attempts to escape, the Pilgrims finally succeeded, arriving in Amsterdam on a Dutch ship.

Soon after, they applied to the authorities in Leyden to settle there. John Robinson, their pastor, made a formal application to the Burgomasters and Court of Leyden, stating that about 100 English men and women wanted to come to the city to live "and to have the freedom thereof in carrying on their trades, without being a burden in the least to any one."[4]

The application was granted on February 12, 1609. The Dutch authorities declared that "they refuse no honest persons free ingress to come and have their residence in this city, provided that such persons behave themselves, and submit to the laws and ordinances." Their coming, the Dutch authorities added, "will be agreeable and welcome."[5] As early as the 1600s, the Dutch—with few natural resources of their own—realized the importance of human capital.

The Dutch didn't provide a welcome-wagon of gifts and subsidies: there were no govern-

ment handouts. What they did offer the Pilgrims was freedom—the freedom to worship according to their consciences as well as to succeed or fail in the Dutch marketplace.

Britain's King James, hearing of the Pilgrims' arrival in Leyden, sent a letter of protest to the town authorities. Jan Van Hout, secretary of the City of Leyden, gave a polite reply, but made no effort either to expel the Pilgrims or to help King James capture them.[6] The Pilgrims were *free men.*

The Meaning of Freedom

Free men. For the Pilgrims, this was a new idea. Just what did it mean to be free? With the external pressure of persecution lifted, would the Pilgrims remain true to their original calling? Or would they turn liberty into license and lose their distinctive identity? Time would show that the Pilgrims took seriously their responsibilities of self-government. Indeed, the Dutch experience would prove to be an excellent half-way house to the freedom the Pilgrims would find in the New World. For the next 11 years, the Pilgrims took advantage of all the opportunities that Dutch society offered.

Because of their excellent reputation for honesty and hard work, the Pilgrims were able to obtain loans and jobs which they needed to set themselves up in Holland. In a market economy, there is no substitute for keeping one's word and honoring contracts. William Bradford, who later became governor of Plymouth Colony, wrote: "And first, though many of them were poor, yet there was none so poor but if they were known to be of that congregation the Dutch (either bakers or others) would trust them in any reasonable matter when they wanted money, because they found by experience how careful they were to keep their word, and saw them so painful and diligent in their callings. Yea, they would strive to get their custom and to employ them above others in their work, for their honesty and diligence."[7]

Most of the Pilgrims went to work in the textile industry, something for which they had little experience. William Bradford became a fustian worker, while others became weavers, woolcombers, and merchant tailors. In England, almost all had been farmers, following the same patterns of medieval agriculture that their fathers and grandfathers had followed. It must have been hard for grown men to learn a

new trade, but it was the price they had to pay to live in a relatively free society. Moreover, it helped to make the Pilgrims an adaptable and teachable people.

At first, the Pilgrims held church services in the homes of various members. But in 1611, the Pilgrims bought a large house to be used for church services and as a residence for their pastor, John Robinson.[8] Left alone by the Dutch, the Pilgrims were finding that Christians could support a church without the aid of government. In Robinson's house, the Pilgrims continued to exercise the congregationalist form of church government which would have such a great impact on American republicanism. The New England town meeting traces its origin to the congregational church, not to ancient Greece, as many high school history texts erroneously teach.

The Pilgrims also took advantage of Holland's laissez-faire government to set up a small publishing house. Working near the limits of the long arm of King James, William Brewster and Edward Winslow ran a printing press where Puritan tracts and books were published and sent back to England. In all, Brewster published between 15 and 20 books. Unfortunately, the Dutch could not withstand the pressure from the English government forever, and were compelled to shut down Brewster's press in 1619. Yet they refused to arrest Brewster himself.[9]

Tolerance

The Netherlands' atmosphere of religious freedom tended to have a liberalizing effect on the Pilgrims. John Robinson, for example, was invited to debate at Leyden University. Although he never changed his Separatist views, he did learn that men of different faiths could live together without killing one another. Later, in the New World, Plymouth Colony would prove to be a handy buffer zone between the Puritans' Massachusetts Bay Colony and the more radical colonists in Rhode Island. When Harvard's first president, Henry Dunster, for example, resigned because he came to reject the Puritan doctrine of infant baptism, he settled in Plymouth. The Pilgrims also believed in infant baptism, but they had become tolerant enough to "agree to disagree" with other Christians like Dunster.

The Pilgrims weren't the only ones to benefit from the freedom offered by seventeenth-century Dutch society. Indeed, as one historian put it, there was a steady "flow of exiles, English and Scottish, who sought refuge in Holland from the religious persecution and political violence of seventeenth-century England and Scotland."[10] Literally thousands of English and Scottish Dissenters, unwelcome at Oxford and Cambridge, were educated at the Universities of Leyden and Utrecht. Even John Locke, who had to flee England, benefited from refuge in the Lowlands. Historian Dr. R. Colie has written: ". . . in the city of Amsterdam where writing and printing were so natural to all great minds, Locke began to become Locke, and the obscure political exile turned into the philosopher *par excellence* of a new regime in thought."[11] And when the people of England sought a new pair of monarchs to usher in an age of toleration and freedom, they found them in Holland: William and Mary. The result was England's Glorious Revolution, one of the few bloodless revolutions in history. A year later, England had a Bill of Rights.

The 11 years the Pilgrims spent in Holland saw them grow in responsibility, adaptability, and self-government. As Bradford Smith put it in his biography of William Bradford, "The libertarian tradition at Plymouth, with its profound influence on American life, is not primarily English. It is Dutch. Simple justice demands that we acknowledge this. . . . Thus, during their Leyden years, were the Pilgrims perfecting themselves for the undreamed of work of founding a new nation. In religion, they grew milder and more tolerant. In business and craftsmanship they learned a great deal from the thrifty, ambitious and highly capable Hollanders. Too, the Dutch flair for efficient government and record keeping, the spirit of republicanism and civic responsibility were to bear unsuspected fruit in a distant land."[12]

The Pilgrims left Leyden in 1620; William Bradford described their departure in a now-famous passage which later gave the Pilgrims their name: "So they left that goodly and pleasant city which had been their resting place near twelve years; but they knew they were pil-

Edward Winslow (1595–1655), Mayflower Pilgrim, a founder and governor of Plymouth Colony.

grims, and looked not much on those things, but lift up their eyes to the heavens, their dearest country, and quieted their spirits."[13]

The Mayflower Compact

When the Pilgrims finally landed in America, Separatists and Anglicans joined together to form America's first written constitution—the Mayflower Compact. It was a crucial precedent for self-government in America.

Despite their experience in Holland's free economy, the Pilgrims tried a brief experiment in agricultural socialism when they arrived in America. This experiment, based on a false reading of the Book of Acts, caused widespread starvation. Fortunately, before it was too late, the Pilgrims saw their error and abandoned their "common course" in favor of private property. As Bradford later explained, "This had very good success, for it made all hands very industrious, so as much corn was planted than otherwise would have been by any means the Governor or any other could use, and saved him a great deal of trouble, and gave far better content. . . . The experience that was had in this common course and condition, tried sundry years and that amongst godly and sober men, may well evince the vanity of that conceit of Plato's and other ancients applauded by some of later times; that the taking away of property and bringing in community into a commonwealth would make them happy and flourishing; as if they were wiser than God."[14]

Some present-day historians believe that the Pilgrims have been overrated, that this little band of 100 or so English farmers doesn't deserve such an exalted position in the popular American imagination. Such an attitude is understandable, since most of these same writers disagree with everything for which the Pilgrims stood. Our forefathers knew better. Even before the Revolutionary War, they were celebrating "Old Comers Day" and "Forefathers Day" to honor the coming of the Pilgrims and, more important, the values they represented—including religious, civil, and economic liberty.

This Thanksgiving, let's remember that the material blessings most of us will enjoy this season were made possible by the principles of self-government under God that served the Dutch and the Pilgrims so well in the seventeenth century. Within the space of 20 years, the Pilgrims moved from a static, medieval society to laying the "cornerstone of a nation." We may still profit from their example. □

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2. Robert A. Peterson, "Lessons in Liberty: The Dutch Republic, 1579-1750," *The Freeman*, July, 1987, pp. 259-264.
3. William Stevenson, *The Story of the Reformation* (Richmond, Virginia: John Knox Press, 1959), p. 125.
4. John Brown, *The Pilgrim Fathers of New England and Their Puritan Successor* (New York: Fleming H. Revell, 1896), pp. 120-121.
5. *Ibid.*
6. Mary B. Sherwood, *Pilgrim: A Biography of William Brewster* (Falls Church, Virginia: Great Oak Press of Virginia, 1982), p. 117.
7. William Bradford, *Of Plymouth Plantation*, ed. Samuel Eliot Morison (New York: Alfred A. Knopf, 1952, 1982), pp. 19-20.
8. Sherwood, p. 123.
9. *Ibid.*, p. 134.
10. Charles Wilson, *The Dutch Republic* (New York: McGraw-Hill Book Co., 1968), p. 183.
11. *Ibid.*, p. 175.
12. Bradford Smith, *Bradford of Plymouth* (Philadelphia: Lippincott, 1951), p. 78.
13. Bradford, p. 47.
14. *Ibid.*, pp. 120-121.

PR Morality

by William H. Peterson

What is public relations?

Someone puts poison in Tylenol capsules, people die, and the CEO of Johnson & Johnson is on the spot. As is the CEO of McDonald's when a crazed gunman invades one of its restaurants and shoots down 22 people.

As John deButts of AT&T put it, public relations means CEOs have to "Face the Nation" and "Meet the Press." CEOs also have to spiff up the corporate image, cope with unseemly events, be upright community leaders, support good causes, and practice corporate philanthropy. Public relations also means, more broadly, gaining public support for some activity, cause, product, movement, institution, region, corporation, or industry.

But those meanings are still too wishy-washy for Marvin Olasky, a professor of journalism at the University of Texas at Austin and author of a brilliant analysis, *Corporate Public Relations: A New Historical Perspective* (Lawrence Erlbaum Associates, 365 Broadway, Hillsdale, NJ 07642, 1987, 190 pp., $24.95).

He seeks to inject a moral dimension into what passes for public relations, a profession that critics have derided as so much "ballyhoo," "huckstering," and "press agentry," as so many "high-priced errand boys and buffers for management."

Look, says Olasky, how sycophantic if not Machiavellian public relations frequently has become. The public relations counselor all too often is a weather vane advocate who meets plots with counterplots, whose unspoken motto is: My cause, company, industry, or client right or wrong. Accordingly. . .

Our adversary issues polls, we issue polls. They hire academics, we hire academics. They parade doctors, we parade doctors. The decades-old public relations battle of the tobacco industry and its cancer and heart disease critics is a case in point. Some legislative repercussions: banning tobacco commercials on TV and mandatory warning labels on cigarette packages.

Thus the plotting and counterplotting get morally foggier when public relations gets into the government-industry arena. Industry A retains Washington public relations firm B to deal with country C which pays "starvation" wages and "dumps" its exports on U.S. shores, thereby threatening X thousand American jobs. Solution: pass domestic content legislation or impose a tariff or quota on the offending foreign goods—at the consumer's expense!

Such counterplotting becomes even murkier, morally speaking, with the arrival of PACs—political action committees that dole out big bucks to political candidates whose votes might not be for sale but could be for rent.

PACs as a public relations tool—apart from "speech" honoraria at up to $2,000 a pop for Congressmen and Senators—would have thrilled Ivy Lee and Edward Bernays. Lee and Bernays were two public relations pioneers whose careers earlier in this century are traced

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by Olasky and whose adherence to the truth and unmanipulated public opinion may not always have been of the highest order. Olasky quotes from the blunt Bernays book of 1928, *Propaganda:*

> The conscious and intelligent manipulation of the organized habits and opinions of the masses is an important element in democratic society. Those who manipulate this unseen mechanism of society constitute an invisible government which is the true ruling power of our country.

Even before Lee and Bernays, the art of massaging public opinion and enlisting government action was hardly unknown. The art seemed to follow the reply of Cornelius Vanderbilt to a newspaper reporter that "the public be damned." This was countered by the much-publicized idea of Ivy Lee, public relations counselor to John D. Rockefeller, that "the public be informed."

But just how is the public to be informed? Or is now and then the public in fact disinformed?

COURTESY OF CHICAGO HISTORICAL SOCIETY

Samuel Insull (1859–1938)

The Art of Winning Friends

Olasky recounts how railroad executives like Charles Francis Adams, Jr., of the Union Pacific and Chauncey DePew of the New York Central worked hard to win friends and influence people against competition in rail transportation which they variously described as "internecine," "cut-throat," "predatory," "dog-eat-dog," or by any other invective handy to the PR fraternity of the day.

One answer, argued Adams and DePew, was a "constructive" Federal rate-setting bureau. This answer was strangely seconded by farm organizations who likened railroaders, meat packers, coal operators, and the like to "robber barons," a phrase circulated by Ida Tarbell, Lincoln Steffens, and other "muckraking" commentators of industry in that era.

In any event, President Grover Cleveland signed the Interstate Commerce Act into law on February 4, 1887. Thus did the Interstate Commerce Commission, granddaddy of the Federal regulatory agencies, come into being. And so was transportation pricing bureaucratized and politicized—i.e., wrested from the free market.

In like manner, in the account of Olasky, did utility magnate Samuel Insull, as president of the National Electric Light Association, pull public opinion strings, campaigning that electric utilities are "natural monopolies," that "franchise security" could best be achieved by government utility rate- and profit-setting commissions.

The campaign largely worked, even if recent analysis shows that there is nothing natural about such monopolies, and economists have demonstrated that competition in electricity provision can lead to lower prices and better service.

Olasky also describes how corporate public relations people pulled out the stops to promote FDR's woebegone "Blue Eagle" National Recovery Administration program in 1933 to boost depressed prices and cut competition through official industry-cartelizing "codes." The then-perceived problem was deflation.

In early 1971 the perceived problem was inflation. So the corporate PR machine again went to work, this time on behalf of wage and price controls, which Richard Nixon instituted

on August 15, 1971. The controls failed, with the Consumer Price Index jumping 8.8 per cent in 1973 and 12.2 per cent in 1974, the year in which the controls were lifted.

So avoid moral ambivalence and unholy alliances, counsels Professor Olasky to public relations practitioners and counselors, especially alliances with the state. He even counsels emphasizing *private* relations rather than public relations so as to help keep private enterprise private.

With courtesy and firmness, public relations managers should begin to tell presumptuous regulatory-minded bureaucrats, professors, fund-raisers, news reporters, and especially politicians: "Leave us be. None of your business."

In truth Olasky is on to a moral conundrum. But one rub with his advice is seen in our mixed or, rather, mixed-up economy. Businessmen and politicians have become to a considerable extent bagmen to each other. Our once limited government has become unlimited, a *quid pro quo* government in which naked vote-buying and vote-selling are on the auction block.

For sale in terms of votes are legal exemptions, inclusions, subsidies, contracts, benefits, tax breaks, and so on. This is all too often the business of City Hall, the State House, and Washington, D.C.

As H. L. Mencken put it, an election is an advance auction of stolen goods.

The conundrum is real. With the government share of GNP amounting to some 36 per cent (two-thirds of that Federal), and with government rules and regulations impinging on business in a thousand and one ways, how does Mr. Businessman extricate himself from the trappings of the state while safeguarding the interests of his stockholders? Does he not have the First Amendment right of corporate citizenship to speak out on public policies and issues bearing on his company, industry or, indeed, the entire economy?

Is not Marvin Olasky providing, then, a micro solution to what is really a macro problem—i.e., the need to relimit unlimited government?

Who Gives What to Whom?

The problem is further seen in a second incisive Olasky work, *Patterns of Corporate Philanthropy* (Capital Research Center, 1612 K Street, N.W., Suite 605, Washington, DC 20006, 1987, 247 pp., $25 paperback). But here Professor Olasky perceives at least a partial solution to our macro problem as he looks into the billion-dollar public affairs gift criteria of the *Forbes* 100 largest firms, from Aetna Life to Xerox. He sees a funding pattern that raises questions of prudence, ethics, and strategy.

He wonders why, for example, Exxon gives to the National Association for the Advancement of Colored People's Legal Defense and Education Fund which sues corporations on affirmative action grounds, why Chrysler supports the National Organization for Women's Legal Defense and Education Fund which sues firms in comparable worth cases, why Atlantic Richfield gave $200,000 in 1985 to the "liberal" (his word) John F. Kennedy School of Government at Harvard University.

If such giving is indeed "hush money," asks Olasky, does the noise level actually go down? He holds that corporate leaders should rethink their position. He says they should focus on their long-run security and strategically invest in individual-responsibility, free-market, limited-government approaches and organizations —organizations that seek to safeguard and enhance the political, social, cultural, and economic environment in which business operates.

Accordingly he hails the late Henry Ford II who, rather audaciously, quit the Ford Foundation's board of trustees on the moral premise that while the foundation is, in the words of Ford, "a creature of capitalism . . . [i]t is hard to discern recognition of this fact in anything the foundation does."

Would that more corporate leaders would take such a moral stand. □

Why College Costs Are Rising

by John Hood

Government help is rarely helpful. And in the case of American higher education, as administrators and faculty help themselves to billions of dollars in subsidies, government has boosted prices and encouraged waste beyond reason.

College costs are skyrocketing. Though a majority of young people are continuing to seek higher education, either because they hope it will pay off in the long run or because it is expected of them, the burden being placed on families is tremendous. Parents are finding their life savings dwindling under the strain. Young men and women are going further into debt than ever before, hoping that future earnings will make repayment relatively painless. All are wondering if the education students are receiving is worth the investment. And through it all, more and more taxpayers' dollars are being routed through state and Federal programs to fund grants and guaranteed loans.

Since 1980 the cost of going to college has risen twice as fast as the cost of living, climbing 57 per cent between 1981 and 1986. The Consumer Price Index went up 26 per cent during the same period. On average, a four-year college education now costs more than $25,000—while at some elite schools like Harvard and Stanford, the bill comes to as much as $70,000. This explosion of college costs has even outpaced the much-decried increase of medical care costs, up 47 per cent between 1981 and 1986. During the same period, the cost of all commodities went up 12 per cent, while the average cost of all services rose 31 per cent. In short, the cause of burgeoning college expenses lies not in the general economy, but in higher education itself.

The burden on families has become critical. From 1981 to 1986, college costs rose 80 per cent faster than median family income. Expressed another way, the portion of the median family income needed to pay tuition and expenses at a public college or university went from 11.3 per cent to 13.1 per cent over that period. For families sending a student to a private institution, costs went from 31.2 per cent to 40.1 per cent. Has the real value of a college degree increased so much since the beginning of the decade, or are parents simply paying too much for their children's education?

All the available evidence points to the latter conclusion. "I think students are getting ripped off," says Robert V. Iosue, president of York College of Pennsylvania. He points out that American colleges and universities have raised prices even more than the gross numbers show by providing less education per dollar—trimming the school year, requiring and offering fewer classes, arbitrarily declaring three-credit classes to be four-credit classes, cutting the length of classroom periods, and spending less money on libraries and other educational programs. "It is a concerted effort on the part of faculty to say, 'Hey, we are working too hard; let's pull back a bit,' " Iosue says.

Indeed, tuition increases have not improved

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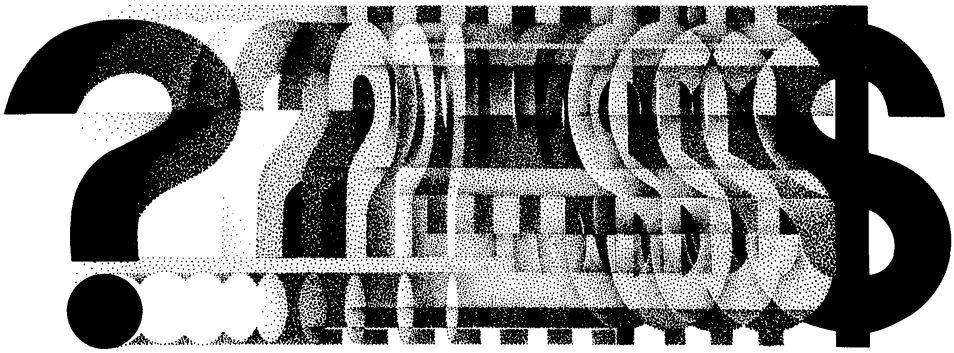

higher education in any measurable way. Academic standards have remained constant or have even fallen during the 1980s. This should be no surprise, since the extra funds raised through price hikes are going mostly to administration, not instruction. According to the Higher Education General Information Survey, the portion of total funds spent on instruction at American colleges and universities declined over 4 per cent between 1974-75 and 1984-85, while the administrative portion increased by almost 13 per cent during the same period. Another portion of the academic pie getting an increase during the period was "student services"—a dubious category including not only institutional financial aid but everything from "safe sex" kits to college-run counseling services.

"Our policy is total Robin Hood," says Eamon M. Kelly, president of Tulane University. "We put our tuition up as high as possible and then put most of the extra money into financial aid." Michael O'Keefe, president of the Consortium for the Advancement of Private Higher Education, puts it this way: "At some colleges, institutional student aid now exceeds total expenditures for the educational program. It makes one wonder what business these colleges are in, higher education or income transfer." Exempting student services and administrative costs, the share of expenditures for almost everything else—research, libraries, instruction, operation, and maintenance—has gone down between 1975 and 1985.

To regular observers of government at work, this scenario is far from unique. In so many areas, ranging from telecommunications to agriculture to electric power, government "help" in the form of subsidies has allowed firms to raise prices above the market price, encouraged waste and inefficient "cross-subsidies" (overcharging one customer to subsidize another), and created an ever-increasing "need" for government expenditures. The higher education market operates in the same manner.

Though President Reagan's foes continue to deny and obscure it, the Reagan administration has been a very generous subsidizer of higher education. Federal student aid appropriations increased from $5.1 billion to $9.0 billion between 1981 and 1986, a 77 per cent increase, while the Consumer Price Index rose 26 per cent. Total available student aid (including loan programs that leverage private funds with Federal dollars) shot up over 60 per cent during the same period, or more than twice the rate of inflation. Not to be outdone, state governments also have allowed the bucks to flow: state subsidies went from $20.9 billion to $30.7 billion between 1981 and 1986, an increase after inflation of about 20 per cent.

More Need-Based Aid

More important, the focus of financial aid shifted during the 1970s from merit-based (including entitlements like the GI Bill and Social Security that are not means-tested) to need-based (like Federal Pell grants and guaranteed loan programs). By the beginning of this decade, the student aid regime had become largely predicated on need, linking the availability of Federal subsidies to students' ability to pay. Colleges, naturally, took the bait—and made school more expensive to attend, thus boosting their Federal dole. This, in turn,

fueled the political pressure on government to increase its need-based student aid. A vicious circle began. By the 1985-86 school year, need-based aid accounted for 95 per cent of all Federal student aid. Only a decade before, such aid accounted for a minuscule portion of Federal aid budgets.

One way to get a better grasp of this process is to consider the difference between an economic market and a political market. In an economic market, the potential to make a profit puts a premium on efficiency. In a political market, in which there is no profit incentive, a premium is placed on sheer expenditure—and, to a certain extent, on inefficiency, since evidence that a particular political program is failing is usually grounds not for ending it, as a business might do, but for increasing its funding (to "solve" the problem). These general principles have been discussed at length elsewhere, but their application to higher education is illuminating. Economist Howard Bowen wrote in his 1980 book, *The Costs of Higher Education,* that colleges and universities exhibit the following market behavior: 1) each institution raises all the money it can; 2) each institution spends all it raises; 3) the cumulative effect is toward ever-increasing expenditures.

Even Governor Mario Cuomo of New York seems exasperated at the tenacious bureaucratic waste of college administrations. At a budget presentation earlier this year, Cuomo blasted the State University of New York for failing to suggest budget savings. "They couldn't identify a single budget-cutting measure—not one penny's worth," he said at the presentation. "I found it really inexplicable. . . .The whole mentality was: 'You get whatever you can for your agency.' "

Waste is rampant in other states as well. Northern Illinois University recently opened a new engineering school, at an estimated cost of $65 million to $85 million over the first 10 years, even though there were 1,700 empty places in three other engineering programs within a 65-mile radius. In the "student services" area, California Polytechnic State Institute offers a program to help freshmen overcome shyness, while Pennsylvania State University gives out Roommate Starter Kits to ease that dreaded campus trauma. Even Harvard University, which offers some of the most prestigious graduate programs in the world, managed to spend $100,000 building a guardhouse that a Boston hotel later duplicated for $5,000.

Absence of Price Competition

One factor behind these costly mistakes and extravagances is the virtual absence of price competition, especially among private schools. "The goal of pricing is to get into a pack," says Christopher Small, vice-president of the University of Tulsa. "You want to be a part of a group, not an aberration." Though this phenomenon has long been accepted in the Ivy League, where attendance has become a luxury good for the very rich or academically gifted, pack pricing—or pricing high to boost prestige—can be found in other areas. At a Washington higher education seminar earlier this year an administrator at one Michigan college joked that he was considering writing an "honest" tuition-increase letter to parents, saying that the school is maintaining high tuition for prestige rather than, as asserted in previous years, to offset rising operational costs.

In fact, there is an added irony in the higher education market: since colleges seem to be getting away with steep tuition hikes without losing a significant number of students, they have come to rely on such hikes to fuel their expenditure binges, while keeping the proceeds of other fund-raising activities—like charitable donations and investments—"in reserve." Even as college administrators justified price increases on the grounds that more money was needed to meet operating expenses and to fund student scholarships, charitable contributions to higher education rose from $4.2 billion in 1981 to $6.3 billion in 1985, a 22 per cent increase when adjusted for inflation. Between 1981 and 1986, endowments of higher education institutions grew from $20.9 billion to an estimated $42 billion, a 60 per cent increase after inflation. The money was there, but the cushion provided by government subsidies allowed administrators the luxury of raising prices instead.

Why is it that colleges have been able to boost their prices without losing many stu-

dents? According to the laws of economics, it would seem that charging more than the optimum market price would cause supply to exceed demand. Yet total enrollment has fallen only once during this decade (in 1984) despite the fact that the college-age population has shown a marked decline. Higher percentages of 18- to 24-year olds went to college in 1985 than in 1980. According to a recent Bureau of Labor Statistics study, 58 per cent of the high school class of 1985 went on to college in the fall, compared to 49 per cent in 1980.

This continued high demand, in the face of rising prices, can be attributed to many factors. Polls show that a large majority of Americans think a college education is more important today than it was in the past. Therefore, it appears that (for now) families are willing to pay exorbitant amounts of money, perceiving that the investment is worth it. To be sure, it is obvious that one factor elevating college education to this revered "necessity" status is the availability of government subsidies, especially guaranteed loan programs that delay the real costs of education until later. The phenomenal number of defaults on such loans demonstrates their economic inefficiency, as well as their growing strain on government budgets. According to Education Secretary William Bennett, defaults last year cost taxpayers $1.1 billion, up from $254 million in 1980 and $117 million in 1975.

Who Pays the Bill?

The high cost of government loan defaults spotlights the most important factor in maintaining the inordinate demand for higher education: consumers of the product are not the same as the purchasers of the product. Taxpayers, who may or may not have college-aged children, foot a large part of the education bill. Uwe Reinhardt, professor of economics at Princeton University, asks: "Where is the justice in taxing a young auto mechanic to provide a heavily subsidized education for a friend who will earn three times as much money when he gets out?" *Newsweek* (May 18, 1987) points out: "To some critics that amounts to a policy of robbing the poor to pay the soon-to-be rich." Once again, a government program to redistribute wealth and opportunity has become a burden on the very people it was supposed to help—the poorer members of society. In this case, government has taken on the rather bizarre role of taxing one group to help another group become educated, who can then turn around and compete with the first group—usually successfully—for jobs and economic opportunities.

One effect of this artificially sustained demand for college degrees is that it provides administrators with the resources to engage in inefficient cross-subsidies. A cross-subsidy is simply the "overcharging" of one customer to subsidize the "undercharging" of another. It is a common practice, but government intervention frequently distorts its use beyond efficient limits. For example, in the currently "deregulated" telecommunications industry, the federal government requires local phone subscribers to pay an extra monthly fee to their Bell company, which then is used to help the Bells compete for lucrative business telecommunications contracts. In much the same way, government subsidization of general student demand allows colleges the luxury of keeping graduate student tuitions at or near the price of an undergraduate education—even though graduate students cost a lot more to educate than undergraduates. Scholarship programs also are the beneficiaries of cross-subsidization, as high tuitions for all students fund scholarships for a few of the most academically gifted students. Both types of cross-subsidies help schools in the competitive segment of the education marketplace—attracting academic "stars," athletes, and promising doctoral candidates—by overcharging students in the uncompetitive, government-protected market for general undergraduates.

Naturally, advocates of government funding for higher education claim that other factors besides Federal and state involvement are responsible for rising prices. The most common argument is that since higher education is so labor-intensive, prices will tend to rise more readily than in private business, because technology and other means of reducing costs are not applicable. To some extent, this is true. But costs in other labor-intensive industries have failed to keep up with the rise in higher education costs.

And methods for increasing efficiency in higher education have been successfully tested at many schools. Charles S. MacKenzie, president of Grove City College in Pennsylvania, suggests that colleges "take a look at things like whether low student-faculty ratios really improve teaching, and the extent to which the tenure process prohibits needed flexibility."

Furthermore, the major increase in labor costs during the 1980s has been for administrative positions, not teachers. A survey by the College and University Personnel Association found that, although faculty salaries rose 5.9 per cent from 1986 to 1987, the salaries for presidents, chancellors, and other top posts went up 7.3 per cent during the same period, while alumni affairs directors' salaries climbed 10.3 per cent.

Although some officials have correctly diagnosed that government aid programs are to blame for the college cost crisis—William Bennett's Education Department being a notable example—in many cases they have advocated simply replacing "bad" programs with "good" ones. Seizing upon the popularity of individual retirement accounts, some states have come up with plans to set up government pools of funds deposited by parents for their children's education. These "education trusts," run by bureaucrats, supposedly would offer parents a painless, secure way of stockpiling potential tuition payments. But as Peter J. Ferrara recently pointed out in a Heritage Foundation report, education trust plans could exert even more upward pressure on college costs, because substantial new funds would be accumulated which parents would have to spend on higher education within a specified time period—or else suffer heavy taxation or even loss of their funds altogether. Funds committed to education in this manner will isolate colleges still further from market forces.

Another proposed solution to the crisis, an "income contingent loan," is now being tested by the Education Department in a five-year pilot program. This program, among other things, would spread the burden of repaying loans over a longer period of time, during which a college graduate's income could be expected to increase. In theory, the pilot program is admirable because it will reduce the interest rate subsidy to students, and may be fairer to taxpayers without a college education, says Robert Staaf, an economics professor at Clemson University. But he adds that the idea simply doesn't get at the root of the problem—government subsidies. A better approach would be to cut loan subsidies, thereby providing students with the incentive to reevaluate their return on higher education while pressuring colleges to reduce costs. But, Staaf concludes, "this effect is likely to come about only if the government gets out of the loan business."

Only when government steps out of the education funding picture once and for all will the upward pressure on college costs subside, and the burden on students and their families lessen. This is but one more application of the axiom coined over 200 years ago by French businessmen in negotiations with their "helpful" government bureaucracy: "If you truly want to help us, leave us alone." □

Education in America

IDEAS ON LIBERTY

Why should the money of one citizen be taken by force to finance the education of other peoples' children, any more than to finance the building of other peoples' homes, the gasoline for other peoples' cars, the payment of other peoples' medical expenses? I have yet to hear a compelling *moral* argument justifying coercion for such a purpose.

—GEORGE CHARLES ROCHE III

Minimum Wage, Maximum Harm

by Perry E. Gresham

I learned a very big lesson in a very small town. I was president of a small college, but that college was the biggest thing in town; in fact it was about the only place of employment. Teachers were the principal earners, and their salaries were modest. Children came to town anyway. The baby boom reached into the Allegheny foothills. Town children had limited opportunities to earn spending money. They played in the streets and sometimes got into minor mischief.

At about that time we built a new college library. Moving more than 100,000 books was a considerable project. Money was scarce and costs were rising. A bid to move the books seemed exorbitant. We decided to train the town's young people to carry, haul in small hand wagons and wheelbarrows, and place the books in such a manner that our librarians could complete the process. The youngsters loved it. They earned some spending money and had the new self-esteem that comes from joining a work force. They were learning to go to work on time and feel the thrill of doing something significant for the college.

We had hardly started when the comptroller was informed that we were breaking two laws —child labor and minimum wage. The town young were distressed, and the college was subjected to unnecessary expense. I remembered the wise words of Walter Lippmann. In his book, *The Good Society,* he made the observation that good intentions in the field of government action for social change often bring about unexpected and unfortunate results. The legislators who perpetrated the laws meant to help the children and the poor. The effect of the laws was damage to both the poor and the eager young.

Van Wyck Brooks called America one of the oldest countries in the world. He used the term "old" in a pejorative sense as neglected, run down, cluttered with trash, dilapidated, and smitten with desuetude. The work of cleaning up the countryside or doing minor chores around the house is inexpensive, but unlikely to command minimum wage. Old, handicapped, inexperienced, and otherwise limited workers could find occupation in such endeavors—but few employers would be willing to pay the minimum wage. Only the rich or the government could afford to spend a qualified worker's wage for such marginal activity. The government could do it only by increasing taxes.

One's labor is the most valuable property one has to sell. If I wish to work for a small wage, and someone wishes to hire me, why should the law forbid it? The answer is that politicians find this kind of legislation to be popular with special interest groups and, at the same time, small drain on the public purse. They are apparently insensitive to the damage wrought against the young, the old, the handicapped, and the unemployed.

In order to gain perspective on this problem, let us talk about houses. A person who wishes to sell a house would be in great trouble if the government were to establish a minimum price for houses. Suppose an average home sells for $100,000 in our bloated market. The builders might form a lobby for a minimum housing law that would permit no sale for less than $75,000. The politicians might weaken and pass the law.

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What happens to the old person who loves his modest $50,000 home but, for reasons of age, must give it up? Think, also, of the poor person who needs shelter, but cannot afford a $75,000 home.

Or we might think about commodities. Wheat now sells for about $3 per bushel. Suppose Congress were to pass a law fixing $2 as the minimum price for wheat—this with severe penalties for those who sell wheat of lesser quality for $1.75 per bushel. What could a farmer do with his crop of inferior wheat? Those who need less expensive grain for animal food or any one of many purposes would find the purchase of $1.75 wheat to be illegal. Both seller and buyer would be guilty of crime.

Consider the effect if live cattle, now selling for $75 per hundredweight, were to fall victim to those attempting to jack up the price by law, and Congress would make selling cattle at $50 a hundredweight a felony. What happens to the marginal rancher whose cattle are worth no more than $50? An honest farmer or rancher, selling inferior cattle to eager buyers, might go to jail.

Lyndon Baines Johnson, my old friend from Texas, loved to say, "Come now, let us reason together." He then proceeded to ignore reason and rush to government intervention. If we would truly reason together we would know that many people have labor to sell, while but few have houses, wheat, and cattle to sell. Some such labor is substandard. Beginners are worth less on the market than experienced workers. Mentally handicapped persons, who could perform such useful but impecunious tasks as collecting abandoned trash or sweeping sidewalks, cannot sell their labor on the market for as much as those who handle computers or analyze the stock market. Why should Congress feel free to pass laws that would send people to jail for selling their labor for less than the minimum wage? Yet some prominent people are talking of raising it to $5 an hour!

Experience has taught me that political opinions are not influenced by reason. People often misread their own best interests on account of group opinion. Many young people who are offered work which is legally excluded from the minimum wage law destroy their opportunities to gain experience, and spending money, by demanding minimum wage. How hard it is to see clearly that the choice is not between $10 a day and the minimum wage, but between $10 a day and nothing.

I hear the cry that low-salaried workers are shockingly underpaid—that they do not make enough to live on. This is true. No one in history has ever been able to guarantee plenty for everybody. The idea that everybody can live at the expense of everybody else is very appealing, but impossible. There is a way for low-wage people to improve their earnings: Develop the skills that our society needs and a higher wage will be forthcoming. If a person is working for minimum wage at a fast-food place and wishes to make as much as $5 an hour, the way to accomplish this challenging feat is to do the work so well that the wage is increased, or else find an employer who has sense enough to hire competence and pay for it. The market, and not the government, is the open road to the happy land of higher wages.

Those of you who chance to read this article will probably agree with it and say, "Ho hum, what can I do about it?" If, by accident, the article catches the attention of an advocate of minimum wage legislation, my words will be dismissed as the blather of an old and inexperienced professor. The problem, however, will not go away. Repeated witness to the truth will have an influence on sensitive persons. Reaction to over-extended government will eventuate. High taxes and the loss of liberty are as relentless as the tides of the sea, and eventually, corrections will come. A will to learn and repeated witness will exert more influence than we might suppose.

Education is the only solution to the problem. When enough people come to understand the effects of minimum wage laws, the laws will change. Our land could have zero unemployment if we would free ourselves from well-meant restrictions. We could have a beautiful land with tidiness, cleanliness, and affordable help for the sick and the feeble. Special interests would rise in moral wrath against so-called "sweating" or "slave labor," but the workers and the employers would create a free and happy society wherein a person could sell his own labor to the highest bidder. Then we could truly sing, "Sweet Land of Liberty." □

The Inequality of Labor Legislation

by Deborah Walker

Joe is a blue collar worker. He has worked hard all his life, saving and skimping, holding on to the dream that some day he would have his own business. Joe has always been in favor of all kinds of labor legislation designed to "protect" himself and his fellow workers. For example, he knew that minimum wage laws were designed to help the relatively unskilled workers by taking from relatively wealthy employers and giving to workers like himself. Joe did notice, however, that when these laws became effective the employers were not the only ones who had to "give." His best friend, Sam, who had just started with the firm, was soon laid off.

When this happened, Joe began to analyze the moral principle underlying labor legislation. The "regulators," he concluded, had made the decision that the rights of workers were more important than the rights of employers. The employers should be forced to pay workers like Joe a minimum amount. And, furthermore, it also seemed that the rights of the workers who kept their jobs were also more important than the rights of the workers who had to be laid off because of the increased labor costs to the firm. This was about as far as Joe's analysis went. He could not really determine the moral principle underlying the decision that some people's rights are more important than other people's rights, if there were one; but since he was a worker and not an employer, he didn't mind.

Joe eventually became a member of a union.

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"Is there a moral principle behind the idea that some individuals' rights are more important than other individuals' rights?"

The union leaders were always complaining about competition from workers who worked at home, who weren't members of the union. The union leaders began claiming that those who worked at home weren't keeping adequate records about the wages they received and about their working conditions. If people continued to work at home, the union claimed, employers could easily exploit workers by paying them less than the minimum wage and by not abiding by all the other terms of the Fair Labor Standards Act. The only to be sure this act was being upheld was to make a new regulation against working at home. The union had convinced Joe that this new regulation would benefit him. After all, those people who worked at home were "unfairly" competing with Joe and his fellow union members.

Again Joe noticed that it was not just employers who paid a price for this legislation. Joe's Aunt Betty, who had arthritis in her hips, could not leave her home without undergoing a considerable amount of pain. Despite this handicap, Aunt Betty had been a productive, self-sufficient member of the community, until she

was told she could no longer work at home.

Joe realized that his rights as a union member seemed to override the rights of the home workers (including Aunt Betty) and the rights of the entrepreneurs who employed them. But again Joe thought it was fine, as long as he benefited.

Joe had always been in favor of affirmative action—who wouldn't be? He knew that his employer deliberately hired minorities and women who would not have been hired had his employer not been afraid of an affirmative action lawsuit. It was only fair, thought Joe, that the rights of these people be considered more important than the right of his employer to hire whoever he felt would be the most productive. And it also seemed only fair that the rights of minorities and women be considered more important than the rights of those individuals who would have been hired if it were not for affirmative action.

The day finally arrived when Joe felt he was financially able to quit his job and open his own restaurant. In his efforts to begin operation, however, he found himself lost in a maze of bureaucratic regulations. He could not sell liquor without a license. He could not open his doors until he met the specifications of the Public Health Administration. He could not use his neon sign because of zoning laws. And the list went on and on. Joe managed to deal with all the regulations and specifications and finally opened his doors.

Financially strained, Joe thought he could still make money by cutting costs. But Joe soon discovered that, again, regulations made it difficult for him to cut costs. *He* now had to pay at least the minimum wage to all of his employees—even the ones he didn't find worth the wage rate. Now *he* had to make sure he was hiring minorities and women to avoid a lawsuit. Now *he* had to meet the requirements of the Occupational Safety and Health Administration.

Within a few months, Joe had to close. His life-long dream was dead. The people for whom he had provided jobs were once again unemployed.

Is there a moral principle behind the idea that some individuals' rights are more important than other individuals' rights? What is this moral principle? Equality of opportunity?

All Joe ever wanted was the opportunity to advance from employee to employer. But he was denied that opportunity in the name of "equality of opportunity." Somehow, to Joe, none of it made sense. When he was an employee—lucky enough to stay employed—his rights were always "protected" at the expense of others. But what rights are these? The right to a job? But these regulations destroyed jobs. The right to a minimum income? But these regulations caused some workers to find themselves earning nothing at all.

Joe felt deeply violated. He nad worked hard all his life to earn enough money to open his business. It was *his* money, *his* hard work, *his* time, *his* life! Now, within a few short months, it was gone. The very regulations which had "protected" him through the years had taken away his life-long dream.

There is no moral principle behind what happened to Joe. Regulations are not passed into law in order to protect a "universal right"—such as the right to own oneself. Regulations are passed into law in order to benefit some at the expense of others. Those most politically powerful decide what and whose "rights" are most important. Indeed, it is at their discretion to decide what is or is not a "right."

When the Founding Fathers wrote that all of us are created equal, they meant equal in the eyes of the law. Every individual should be subject to the same laws, the same "rights," at all times, under all circumstances. Joe objected when his right to his own life—his property—was violated, yet he supported the same violation of the rights of others, as long as he benefited. Unfortunately, the political process promotes such hypocritical behavior.

There is a moral justification for the right of a man to own himself, including his time and effort and the property he honestly accumulates through that time and effort. The moral principle is equality—but equality in the true sense. For one individual to have coercive power over another is to have drastic inequality—some are *owners,* while others are *owned.* The forced redistribution of income, whether through minimum wage laws, home work laws, or affirmative action legislation, is the very essence of this inequality. □

The Banking Crisis

by Hans F. Sennholz

The Federal Savings and Loan Insurance Corporation (FSLIC), which insures deposits in savings institutions, is in dire straits. Its liabilities exceed its assets by more than $13 billion, up from $6.3 billion a year ago. Currently 505 of the country's 3,120 Savings and Loan Associations are insolvent, and another 435 institutions are barely solvent. FSLIC funds are not adequate to resolve the financial dilemma. Once again, Congressional action may be needed to keep the system afloat. The U.S. government may have to come to the rescue, although just last year Congress authorized the sale of $10.8 billion in bonds over three years to save the ailing industry.

In testimony prepared for the Senate Banking Committee, the General Accounting Office, which is the auditing arm of Congress, estimated the costs of saving more than 200 "hopelessly insolvent" associations at $17.4 billion and of saving another 300 units at $26.4 billion to $36.4 billion.[1] Private analysts estimate total costs to be as high as $60 billion. All such calculations rest on the precarious assumption that interest rates will not rise significantly and that no new problems will arise in the next ten years.

Such a view is extremely optimistic. After all, interest rates are likely to rise again during the 1990s as a result of two Federal policies. The budget deficits are likely to continue to consume business capital *en masse,* crowding out private demand and frightening creditors who finance the deficits. Moreover, the rate of price inflation is likely to rise during the 1990s because the extenuating circumstances of the 1980s are drawing to a close, such as the agricultural depression in the U.S. and falling energy prices.

A more realistic appraisal of the financial situation would consider additional factors. Since 1982, the U.S. has experienced one of the longest booms in recent history. And yet, the U.S. government had to rescue the deposits of millions of savers from 620 commercial bank failures and forced mergers. Some 100 Savings and Loan Associations failed and were liquidated; another 505 are officially insolvent. Federal agencies had to make good some $200 billion of depositors' savings lost in failures involving 7 per cent of some $3 trillion deposits in U.S. savings institutions. If this is peacetime prosperity, what is to become of the financial institutions during the 1990s when the great boom is likely to give way to a recession? After all, recessions follow booms as night follows day.

Persistent economic instability is aggravating the financial situation. The federal government is suffering huge budget deficits that are draining the capital markets, boosting interest rates, and causing large trade imbalances, which in turn are threatening free-trade relationships. Similarly, third-world debt, which has more than quintupled during the 1970s and 1980s, is casting a shadow on the banking system. The funds have been wasted on government enterprises and political largesse, lost in a fruitless effort to export American know-how and prosperity. The policy has cost Amer-

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icans hundreds of billions of dollars and now is jeopardizing the solvency of the financial institutions that extended the credits.

The American financial structure is teetering on the edge of disaster.[2] A time bomb is ticking away under both domestic banking and international finance. Ticking loudly, it makes us wonder when it will go off. It may explode suddenly in the form of a classic "bank-run" or an international panic. Depositors filled with fear and in doubt about deposit insurance and government guaranties, may suddenly rush to withdraw their funds from all savings and loan associations. They may lose faith in the central pillar of the American financial structure, the Federal guaranty, which is bending and cracking under the heavy load of bank losses and Congressional reluctance to cover those losses. The run would be like a bolt from the blue, spreading from the thrifts to all banking, and from the U.S. to all corners of world finance.

Private foreign investors may suddenly bail out, frightened by a sudden outbreak of U.S. inflation, by poor trade figures or harmful government policies, or merely by some unfortunate pronouncement by foolish officials. Sudden foreign withdrawals of large funds would strain the American system and test the solvency of many institutions. Without immediate support by the U.S. Congress, many undoubtedly would fail.

The bomb may explode when foreign central banks abandon their dollar-support operations. Stephen N. Morris, an economist at Washington's Institute for International Economics, estimates that major foreign central banks bought $130 billion last year to support the U.S. dollar and that, by the end of 1987, the 20 largest foreign banks were sitting on a stockpile of more than $454 billion.[3] If these holders of dollar reserves should lose confidence in our financial structure or in the resolve of our financial authorities to correct its lingering defects, a crisis may erupt. When the financial wheels grind to a halt, the system that was born of government thus will return to government for repair and restructure.

We must not allow it to perish suddenly, which would not only spell ruin to many sound institutions alongside the failures, but also ravage the capital market and depress economic activity. It would turn today's creeping nationalization into galloping regimentation. Indeed, a financial crash would have ominous consequences for our economic, social, and political lives.

An Artifact of Government

The American financial edifice was built by legislation and is maintained by regulation. It is as rigid and inert as politics, and as complex as the tangled web of bank regulation. Designed by the New Deal politicians of the 1930s and embellished by their successors in the '40s and '50s, it is clearly incapable of coping with the market forces of the 1980s and '90s. It is destined to give way to a new order.

The edifice that was built during the 1930s replaced the regulatory structure of earlier years, which was the product of a myriad of Federal and state banking regulations. It practically collapsed in 1931 and 1932. By scores and by hundreds the banks closed their doors. Banks that remained open were forced to curtail their operations sharply. Indeed, banking weakness was a prime factor that added impetus to the Great Depression.

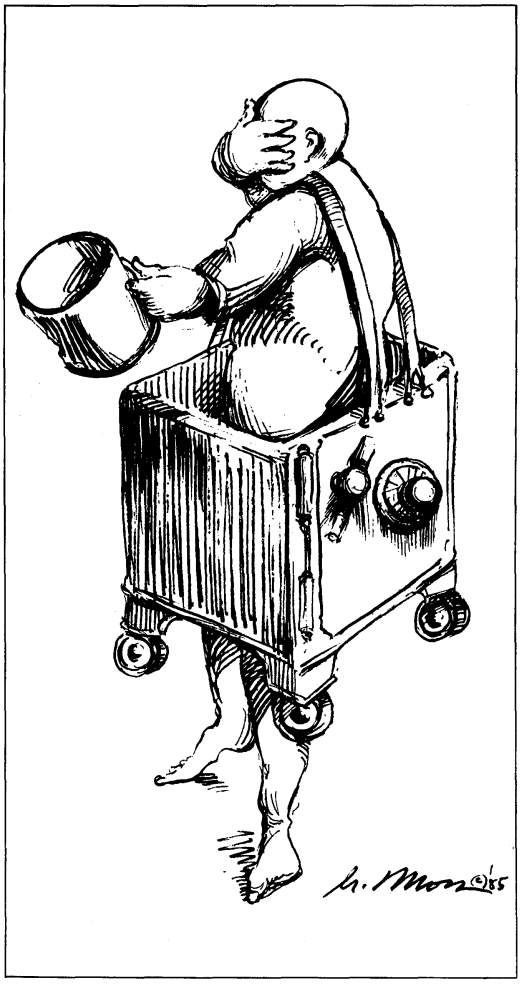
The new system was organized as a cartel-like order, complete with all the characteristics of a monopoly.[4] Rigid entry barriers protected its members from "destructive" competition, as did government regulation of production, pricing, and marketing. The Banking Act of 1933, which also created the Federal Deposit Insurance Corporation (FDIC), separated commercial banking from certain investment banking activities. The portion of the law that effected the separation is commonly called "the Glass-Steagall Act." It was to give stability to the system and guarantee the safety of every bank. Toward that end, the law sought to discourage competition and to set narrow limits on branching. It imposed a "needs test" for the issue of new charters, and fixed interest-rate ceilings to prevent the competition of banks for funds. Deposit insurance by the FDIC, finally, was to make all banks equally safe.

New Deal legislation effectively segmented the financial industry. It created the Securities and Exchange Commission to oversee the se-

curities industry. To facilitate more credit expansion, it granted additional powers to the Federal Reserve System, such as the powers to mandate reserve requirements and to extend credit on government obligations, not just on "real bills." In 1956 Congress passed the Bank Holding Company Act, extending the Glass-Steagall Act's restrictions to corporate owners of banks. Amendments to the Act, passed in 1966 and 1970, further tightened the restrictions. They limited the expansion of multibank holding companies by requiring Federal Reserve Board approval for new acquisitions, and ordered the companies to divest themselves of ownership in businesses deemed "unrelated" by the Federal Reserve Board. All interstate banking was prohibited.

Throughout the years Federal regulators and special-interest banks lobbied Congress to pass more restrictive legislation. After lengthy hearings, Congress usually complied by removing exemptions and broadening regulatory authority. The 1970 amendments sought to bring one-bank holding companies under Federal regulation and impose additional criteria to the "needs test" for permissible activity. Charter applications henceforth had to prove not only that the planned activity was "closely related" to banking, but also of "positive benefit to the public." It also instructed the Federal Reserve Board to determine which activities were permissible for bank holding companies. The Garn-St. Germain Depository Institutions Act of 1982 permitted bank holding companies to engage in some limited "nonbanking activity" provided it was "closely related" to banking.

It is amazing that, after nearly 200 years of banking legislation and regulation, the U.S. government continues to wrestle with the definition of "banking." The 1970 legislation modified the definition of a bank to include all institutions that both accept demand deposits and extend commercial loans. Thereafter, many new institutions sprang up that either accept deposits or extend commercial loans, but not both. Commonly known as "nonbank banks," they could pursue most financial activities without coming under the restrictions and regulations of financial authorities. As "nonbank banks" became increasingly popular



during the 1980s, competing most effectively with banking institutions, Congress proceeded to close the regulatory loophole by passing the Competitive Equality Banking Act of 1987. The Act extended the definition of a bank to all FDIC-insured institutions and subjected them all to Federal regulation.[5]

Winds of Change

The financial cartel system worked for a while. But, like all other cartels, the financial cartel was destined to degenerate as soon as its members were no longer prepared to live by the "stabilization" arrangements and found ever new ways of competing with each other. Even a thick blanket of cartel regulation cannot suppress competition for long. It springs to life in countless forms because man is ever eager to improve his lot. In an economic order based on

private property in the means of production, he can do so best by rendering better services to his fellowmen; that is, he competes with other producers in serving consumers. He does so even within a cartel.

When newcomers are permitted to join the organization, they are likely to add competitive fervor. Foreign bankers are very anxious to enter the U.S. market for obvious reasons: to join the cartel and enjoy its advantages, to outstrip the older members through greater effort and efficiency, and to place their funds at exceptionally high interest rates.

The spirit of competition is gnawing at the foundation of the financial cartel. It is weakening the structure from within and from the outside. Throughout the world, massive capital formation in private-property economies has given rise to new financial centers that compete vigorously with New York. Tokyo, Hong Kong, Singapore, London, and Frankfurt are financial centers that "globalize" the capital market and erode competitive barriers. Shackled and handicapped at home, many U.S. banks have chosen to go offshore and compete in foreign financial centers. Similarly, foreign banks have come to compete vigorously in American markets through branches, agencies, subsidiaries, Edge corporations (which cannot accept deposits from U.S. residents unless the deposits are linked to international trade), and representative offices. In short, the new world of international competition is seriously threatening the old world of protection and insulation.

The spirit of internal competition is clearly visible in the frantic search for new ways to diversify. It is visible in the rise of "nonbank banks" that render financial services formerly reserved to commercial banks. Brokerage houses, money market mutual funds, finance and insurance companies, and retail establishments compete effectively, offering cash management accounts, other liquid accounts, credit card services, and loan services. Merrill Lynch, American Express, and Sears are pointing the way. Financial competition is alive although the regulatory apparatus is fighting it every step of the way.

Technological innovations are forcing their way through the thicket of regulations. The computerization of many financial operations has greatly reduced transaction costs, which is enabling nondepository institutions to offer many bank-like services. The use of automated teller machines (ATMs) has grown dramatically since the late 1970s. Individual ATM systems may soon link up with national and international networks. Thousands of point-of-sale terminals may serve millions of customers using a great variety of credit cards. On the financial horizon, in-home banking promises to offer all the essential banking services, including bill payment, electronic purchases and sales of securities, and so on. Telephone or cable hookups, satellite linkages, and home computers are destined to play important roles in the financial system of the future.

Keen competition is bound to separate the successful enterprises from the failures. The former succeed by best serving consumers; the latter fail because they fail to serve consumers satisfactorily. They may misjudge or ignore consumer choices and preferences, or mismanage their resources, or allow themselves to be misled by political machinations. To rely on cartel regulation and insulation is to invite financial disappointment in the end.

Regulatory Restructuring

Financial observers of all persuasions and ideologies are in full agreement that the American edifice is in urgent need of restructuring. A healthy and viable banking industry needs to generate returns that not only cover its costs but also attract new capital to support modernization and expansion. It must be able to compete with other financial institutions and other business enterprises.

Most legislators and regulators readily admit that a safe and sound system should not be unduly hampered by regulation and supervision. They may even favor some measure of "decontrol" and "banking freedom to operate in the marketplace." They may advocate "product liberalization" by eliminating some restrictions imposed by the Glass-Steagall Act and certain provisions of the Bank Holding Company Act. Yet, they all envision a restructuring that would *strengthen the supervisory and regulatory restrictions on banks*. They em-

phasize "prudent supervision," "careful monitoring," and "limiting the risks" posed by new bank services. In short, the old regulators would like to replace the crumbling cartel wall with a *new supervisory safety and soundness wall.*[6]

The world is a scene of changes. We change and our policies change. But we should always ascertain the direction of the change. To replace one wall with another is to reinforce the old direction. To substitute prudent regulation for imprudent regulation is to continue the regulation; it does not reverse the direction. We may wonder about our destination, but it is rather obvious that legislators and regulators will always be in the driver's seat.

Most writers about financial matters accept it as a self-evident truth that legislators and regulators need to manage the people's finances. They are convinced that no one ought to be free because no one is fit to use his financial freedom responsibly and beneficially. This is why they favor a mandatory deposit insurance system with Federal guarantees. They advocate the separation of banking and securities activities, the separation of banking from commerce, and careful supervision of them all. They prefer a financial structure with thousands of small banks to one characterized by large financial institutions. In short, they thoroughly distrust men of finance, but place their trust in legislators and regulators.

To embark upon financial reform and revival is to discard many false beliefs about finance and the role of government intervention. In finance as in all other pursuits, man is free to choose between two basic systems of economic organization: the individual enterprise system and the command system. Throughout their short history Americans generally opted for the former, the system of private property and individual enterprise. In all matters of finance, unfortunately, they frequently succumbed to the lures and temptations of political command. In money and banking they generally preferred politicians and government officials over bankers and entrepreneurs.

After 200 years of countless banking scandals and unending financial crises it is appropriate to reconsider the direction of the road we are travelling. After thousands of bank failures and billion-dollar losses we may want to reverse our financial direction, turn away from the command system, and seek individual freedom. It is eminently effective and beneficial in all other pursuits; it is likely to be the same in financial matters.

No man is free who is not master of his finances. The American command system is an abomination to all friends of freedom. They will not rest until financial commands finally give way to individual freedom. □

1. *The New York Times,* May 20, 1988, pp. D1, D3.
2. Edward J. Kane, *The Gathering Crisis in Federal Deposit Insurance* (Cambridge, Mass.: MIT Press, 1985).
3. *Business Week,* May 23, 1988, p. 27.
4. Franklin R. Edwards, "Can Regulatory Reform Prevent the Impending Disaster in Financial Markets?" in *Restructuring the Financial System,* The Federal Reserve Bank of Kansas City, 1987, pp. 1-17.
5. Federal Deposit Insurance Corporation, *Mandate for Change* (Washington, D.C.), October 1987, pp. 29-33.
6. *Ibid.,* pp. 98-102.

Money Follows Commerce

IDEAS ON LIBERTY

Money, it should be remembered, is not the leader of commerce, but the follower. It comes, legitimately, only to the individual or to the community as the result of industry and good management; industry and good management do not result from the possession of money.

—CHARLES HOLT CARROLL
(1799-1890)

Decentralization: Freedom by Diffusion

by David C. Huff

One of the beneficial aspects of national election campaigns is their reminder to us that America is becoming dangerously enamored with the false hope of political salvation. The finances, energy, media attention, and zealous devotion heaped upon candidates for high office at times reaches messianic proportions. They provide further evidence that what was once a valid political process now borders on idolatry.

What has caused our nation's obsession with politics? To fix blame upon the electoral system, or upon the candidates, would be inaccurate and overlook the true cause. Such a fixation on politics is but one indication of an increasing drift toward a "Pyramid Society":

> The Pyramid Society is a culture in which a majority of the people spend most of their time transforming the civil government to the near exclusion of themselves, their families, churches, schools, businesses. . . . By changing the powers at the top, we are led to believe that there will be a trickle-down effect of cultural transformation that will blossom into a better society. The problems that a nation faces, as this approach sees it, are solely political. Change the State, and all of society will change with it. This has been the vision of pagan empires since the building of the tower of Babel.[1]

It is easy to see how such a utopian vision produces an unwarranted emphasis on politics.

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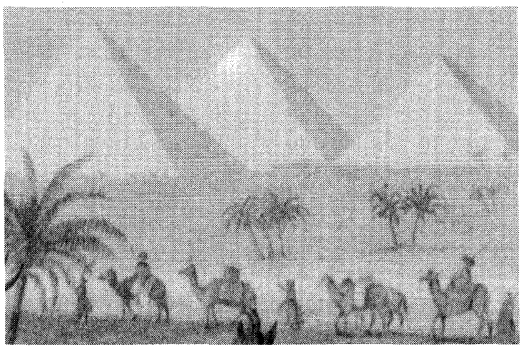

More specifically, the philosophy of the Pyramid Society and its top-down remedies by necessity revolve around the concept of central planning. For this reason, it is especially important that advocates of freedom understand and apply the principles of decentralization.

Historical Precedent

The essence of decentralization is a social order characterized by the diffusion of power away from an authoritarian nation-state where politics, economics, and eventually all of life are regulated through the control of a centralized government. By such diffusion, the potential tyranny of the Pyramid Society gives way to the freedoms of multiple jurisdictions, self-government, and the practical hierarchy of family, community, and local government.

The natural appeal of decentralism can be appreciated by examining its rich historical precedents. Throughout history, the disintegrations of both national governments and totalitarian regimes have been followed by the ap-

pearance of a variety of local assemblies which effectively administered societal affairs. After surveying over a dozen twentieth-century illustrations of this phenomenon, one author has perceptively concluded: "It is striking to reread history with eyes opened to the persistence of this tradition, because at once you begin to see the existence of the anti-authoritarian, independent, self-regulating, local community is every bit as basic to the human record as the existence of the centralized, imperial, hierarchical state, and far more ancient, more durable, and more widespread."[2]

The lessons from history are compelling, and none more so than that of the United States. The decentralist philosophy was a driving force in America's early years, and leaders such as Thomas Jefferson were acutely sensitive to the insidious encroachment of centralism which already had begun during their lifetimes. Jefferson saw in decentralization the spirit of a free society, where each individual would participate in government on a localized, "bottom-up" basis; he envisioned a freedom so important that the individual would "let the heart be torn out of his body sooner than his power wrested from him by a Caesar or a Bonaparte."[3]

Practicality

The repeated emergence of decentralization throughout the centuries should not be considered an anomaly. Indeed, decentralism's longevity and durability bear strong witness to its practicality. Though interventionists stubbornly claim that the need for centralization of power increases as nations become larger and more complex, it is statist programs that have failed time and again.

One important example of the efficacy of decentralization is in the area of economics. The absence of intervention is integral to the successful operation of the free enterprise system. Under laissez-faire capitalism, a society's economy prospers as individuals pursue the improvement of their well-being through the unhampered functioning of supply and demand coupled with the profitable ventures of entrepreneurs. The freedom of choice and diversity of opportunity available in a decentralized free market economy are intensely practical, and become increasingly so as the society expands —for more complexity produces additional choices and enhances the division of labor.

Contrast this with the well-documented and bitter fruits of central planning. As historian Herbert Schlossberg has observed: "The economic results of central direction must, by reason of the central direction alone, be unfavorable, because the system is formally irrational. It substitutes preferences of central planners for the estimations based on a price system that reflects both supply and demand. . . . the planner's will replaces the action of the market."[4]

True freedom, social stability, and economic health can be realized only by applying the practical self-government approach of decentralization.

Future Implications

A survey of American history reveals a disturbing trend toward centralization and a growing ideology of political salvation. To continue down the present path will destroy the freedom of future generations.

Clearly, then, one imperative for our future as a free nation is the propagation and application of the precepts of decentralization; they are an inseparable part of the formula for liberty. By replacing the misguided illusion of political salvation with education and action in the areas of personal responsibility, limited government, free enterprise, and the liberty-producing features of decentralism, our society can avoid the lethal errors of the past: "[the] pyramids are . . . evidence . . . of the political theory of Egypt. Their silent witness in the desert kingdom of Egypt should remind us that any top-down political structure is doomed to fail."[5] □

1. Gary DeMar and Peter Leithart, *The Reduction of Christianity* (Ft. Worth: Dominion Press, and Atlanta: American Vision, 1988), p. 305.
2. Kirkpatrick Sale, *Human Scale* (New York: Coward, McCann, and Geoghegan, 1980), p. 445.
3. *Ibid.*, p. 450.
4. Herbert Schlossberg, *Idols for Destruction: Christian Faith and Its Confrontation With American Society* (Nashville: Thomas Nelson, 1983), pp. 227-8.
5. DeMar and Leithart, *op. cit.*, p. 305.

Broadcasting, Property Rights, and the First Amendment

by Gordon T. Anderson

When radio was still in its infancy in the early part of the twentieth century, no one could foresee the enormous scope of the technological revolution that was then just beginning. And in the midst of New Deal euphoria over central planning, few understood the implications of the Communications Act of 1934, which established the federal government's ownership of the rights to use the electromagnetic spectrum and solidified its absolute power to regulate broadcasting. In the time since, however, it has become evident that Federal control of the airwaves is antithetical to the principles of a free society. By relinquishing its control of the airwaves the government could reaffirm the importance of those principles.

Federal regulation of broadcasting began with the Radio Act of 1912, which tried to set up a system for allocation of the spectrum through the administrative decisions of the Federal Radio Commission, the forerunner to the FCC. Perhaps because radio communication and its potential was so poorly understood at the time, the legislation had a fundamental flaw: it failed to establish any system of property rights in the electromagnetic spectrum.

By the mid-1920s, this omission had become glaring, as scores of competitors routinely jammed each other's broadcasts, both intentionally and unintentionally. The chaos on the nation's airwaves prompted the expanded Radio Act of 1927, and, ultimately, the comprehensive Communications Act of 1934. The latter legislation affirmed the government's ownership of all broadcasting rights and established the Federal Communications Commission, which was given extensive regulatory powers. From the beginning, the use of such powers has been guided by politics, as University of Texas Law Professor Lucas Powe points out in his book, *American Broadcasting and the First Amendment* (University of California Press, 1987).

In the late 1920s, a right-wing religious broadcaster used a 1,000-watt station in Los Angeles as his pulpit, from which he issued blistering attacks on corrupt city fathers. Though many of his scurrilous assertions were later verified, the reverend nonetheless became one of the country's earliest victims of political manipulation of the airwaves. At his renewal hearing in 1930, the broadcaster's license was revoked because his sensational comments were deemed not to be in "the public interest." On appeal, the D.C. Circuit Court upheld the revocation, ignoring the plaintiff's arguments that broadcasting speech was protected by First Amendment guarantees. By refusing to review the case, the Supreme Court implicitly agreed with the lower court's view that broadcasters did not have the right to freedom of speech.[1]

As Professor Powe notes, government domination of broadcasters expanded as the influence of the electronic media grew. Franklin Roosevelt, the first president to grasp the political opportunities mass communication offered, also understood the political danger of vigorous and unfettered broadcasting. Roosevelt expanded the reach of the FCC by appointing as

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its chairman James Lawrence Fly, an activist New Dealer whose principal objective as an administrator was to enact rules barring ownership of broadcasting outlets by newspapers—especially those newspapers which opposed the Roosevelt administration.[2]

Though the courts blocked many of Roosevelt's attempts to censor anti-New Deal broadcasting, later presidents of both parties were more successful in using the ever-broadening powers of the FCC to pursue their own political objectives. Every administration since Truman's has at times used the Commission to favor broadcasters who supported them and to punish those who did not. And despite the fact that the FCC is theoretically impartial, the courts have generally upheld its politicization.

Since the early days of licensing, broadcasters have been mandated to "serve the public interest." This duty can be fulfilled in part by airing public affairs programming, including major speeches by elected officials and political candidates. Until very recently, such political programming had to adhere to the dictates of the Fairness Doctrine, an FCC rule which specified that political programming had to be "objective" and present both sides of an issue. If a station aired a Republican's speech, a Democrat had to be given air time to respond, and vice versa. Violations of the Fairness Doctrine often resulted in heavy fines or loss of license for the offending station.

The First Amendment vs. Government Regulation

Controls over broadcasting content such as the Fairness Doctrine are troubling. Casting aside the dubious proposition that any issue has only two sides, a more significant objection becomes clear: FCC content regulation is fundamentally at odds with the concept of freedom of the press, as television journalist Bill Monroe observed in a 1984 speech: "The First Amendment sets up a clear-cut independence of press from government as the journalistic principle most vital to the American people. But the existing regulatory approach to broadcasting offers exactly the opposite formula: government guidance and government rules *to protect the American people from independent journalism*. The First Amendment idea and the regulation idea are mortal enemies."[3]

Though Monroe's thesis is intuitively correct, politicians and judges have continually rejected it. And while the Fairness Doctrine was officially repealed by the FCC in 1987, there is a major movement in Congress to make the former rules Federal law. Congressional supporters repeatedly cite their obligation "to protect the public interest" to justify the proposal.

In a seminal 1943 Supreme Court decision, *NBC* v. *United States,* the Court gave its judicial imprimatur to an omnipotent FCC by examining the Communications Act of 1934 in detail and firmly establishing its constitutionality. In the majority opinion, Justice Felix Frankfurter contended:

> True enough, the [Communications] Act does not explicitly say that the [Federal Communications] Commission shall have the power to deal with network practices found inimical to the public interest. But Congress was acting in a field of regulation which was both new and dynamic. . . . The Act gave the Commission not niggardly but expansive powers. It was given a comprehensive mandate to "encourage the larger and more effective use of radio in the public interest."[4]

NBC v. *United States* was primarily concerned with antitrust violations in the broadcasting industry, but the Court did briefly consider First Amendment questions of the case. Frankfurter wrote:

> The Regulations, even if valid in all other respects, must fall because they abridge, say the appellants, their right of free speech. If that be so, it would follow that every person whose application for a license to operate a station is denied by the Commission is thereby denied his constitutional right of free speech. Freedom of utterance is abridged to many who wish to use the limited facilities of radio. Unlike other modes of expression, radio inherently is not available to all. That is its unique characteristic, and that is why, unlike other modes of expression, it is subject to government regulation.[5]

The rationale for regulation has been that the number of potential broadcasting outlets is lim-

ited and therefore the government must be the one to decide who can use the spectrum. Frankfurter buttressed this argument by rejecting the plaintiff's First Amendment arguments in this case.

In *NBC* v. *United States* the Court failed to grasp the basic economic fact that all things, including newspapers, are subject to a degree of scarcity. At the time the First Amendment was written, for example, the United States had only eight newspapers. But this did not prompt the Framers to allow the government to regulate the press. In fact, Thomas Jefferson once wrote, "The basis of our government being the opinion of the people, the very first object should be to keep that right; and were it left to me to decide whether we should have a government without newspapers, or newspapers without a government, I should not hesitate a moment to prefer the latter."[6] Jefferson had a reverence for freedom of speech and an unrestrained fourth estate that was lost on Frankfurter.

Red Lion v. *FCC*

The effect of *NBC* was to establish as a legal principle the notion that broadcast speech is inherently different from printed speech in newspapers. The theory rests on the assumption that there is unlimited entry into the print media, but only a finite number of broadcasting outlets. Thus, the airwaves must be subjected to a degree of regulation not accorded the print media. This scarcity rationale has been consistently extended by the courts, including the landmark 1969 decision of *Red Lion* v. *FCC*.

In *Red Lion* the Court affirmed the FCC's control over program content by upholding the constitutionality of the Fairness Doctrine. The case involved a small station in rural Pennsylvania which in the mid-1960s aired a number of vitriolic attacks by conservative preacher Billy Hargis on left-wing journalist Fred Cook, author of the book *Goldwater: Extremist of the Right*. Cook, with help from the Democratic National Committee, convinced the FCC that he was entitled to free air time to respond. In his opinion, Justice Byron White wrote:

> Where one candidate is endorsed in a political editorial, the other candidates must themselves be offered reply time to use personally or through a spokesman. . . . It is not unreasonable for the FCC to conclude that the objective of adequate presentation of all sides may best be served by allowing those most closely affected to make the response, rather than leaving the response in the hands of the station which has attacked their candidacies, endorsed their opponents, or carried a personal attack upon them.[7]

The Court held that the government has a right and a duty to influence the presentation of ideas and issues over the airwaves. By implicitly lauding the "objective of adequate presentation of all sides," the Court effectively discredited the value of individual opinion.

However, in another landmark decision, *Miami Herald* v. *Tornillo* (1974), the Court took a far different view of the obligation of the press to present all sides of an issue. In that case, the *Miami Herald* challenged the constitutionality of a Florida statute which forced newspapers to give space for targets of editorial attacks to respond—a law that was, in effect, a Fairness Doctrine for newspapers. In a unanimous decision, the Court overturned the statute, declaring the sanctity of a free press to be nearly absolute.

A comparison of *Miami Herald* and *Red Lion* is instructive in considering the flawed logic of the Court in broadcasting cases. When radio and television are concerned, the Court has not hesitated to use scarcity as a rationale for minimizing First Amendment rights. Yet in the *Miami Herald* case, Chief Justice Burger noted that modern newspaper publishing has significant entry restrictions just as broadcasting does: "The obvious solution, which was available to dissidents at an earlier time when entry into publishing was relatively inexpensive, today would be to have additional newspapers. But the same economic factors which have caused the disappearance of vast numbers of metropolitan newspapers, have made entry into the marketplace of ideas served by the print media almost impossible."[8]

Recognition of the scarcity of publishing outlets did not compel the Court to uphold the regulation of newspapers. Rather, it strongly reaffirmed the value of an independent press.

Burger wrote, "A responsible press is an undoubtedly desirable goal, but press responsibility is not mandated by the Constitution and like many other virtues it cannot be legislated."[9]

Where Burger's opinion in *Miami Herald* rejected the role of scarcity in providing an excuse for print media regulation, Justice White used scarcity to support the *Red Lion* decision: "Where there are substantially more individuals who want to broadcast than there are frequencies to allocate, it is idle to posit an unabridgeable First Amendment right to broadcast comparable to the right of every individual to speak, write, or publish."[10]

It is interesting to note that both White and Burger cited *Associated Press* v. *United States* (1945) in their opinions. In *Red Lion,* White used it to justify his contention that "there is no sanctuary in the First Amendment for unlimited private censorship operating in a medium not open to all."[11] In the *Miami Herald* decision, Burger considered the *Associated Press* opinion and rejected it as precedent, noting the "confrontation with the express provisions of the First Amendment and the judicial gloss on that Amendment developed over the years."[12]

The reasoning behind the Court's paradoxically different view of the First Amendment rights of the print media and those of broadcasters stems from the Court's apparent belief that the media are more dissimilar than alike. White argued in *Red Lion* that "although broadcasting is clearly a medium affected by a First Amendment interest, differences in the characteristics of new media justify differences in the First Amendment standards applied to them."[13]

This view exists in part because of the failure of the early communications regulators to establish a property-based system for allocation of the spectrum. The response to the airwaves chaos of the early part of the twentieth century was to produce a system in which the government owns all rights to use the spectrum. Broadcasters are the trustees of the right to transmit over government-owned frequencies. In contrast, newspaper publishers are the owners of their means of communication, a crucial distinction.

Centuries-old common law traditions of property rights serve to protect publishers in a way not currently applicable to broadcasting. Since a newspaper is recognized as actual property, it is a far greater offense for a ruling body to dictate what should and should not be done with it. Broadcasters, on the other hand, merely hold a government-granted privilege. They do not own their right to broadcast, and as a result retain no traditional rights of property. In other words, what the government gives, the government can take away.

A Property-Based System

Establishing a property-based system for the use of the electromagnetic spectrum would end the conflict between the First Amendment and government regulation. It would also have other far-reaching implications for society.

Since the spectrum has a variety of uses beyond television and radio broadcasting, the FCC currently must make administrative decisions as to how much of the spectrum to allocate for each particular application. By the FCC's own admission, these decisions are by nature arbitrary. It is simply impossible for any regulatory agency to decide how to allocate scarce resources most effectively.

For example, in the cellular mobile phone industry (which uses microwave radio transmission to connect callers) the FCC had to pick from a pool of 1,200 applicants for the first 90 licenses. When the Commission later assigned licenses in an additional 30 markets, more than 5,000 entrepreneurs applied. Like the television, radio, and satellite industries, as well as many others, the cellular mobile phone industry desperately wants to increase its share of the spectrum. Yet it can do so only with FCC approval, which in a spectrum filled almost to capacity means denying use for some other purpose. Without a price structure to determine the most efficient use of the spectrum, the FCC must weigh competing claims and decide on its own which services are more important than others.

The FCC should immediately undertake a program of privatization of the airwaves. There are a number of ways it could do this. It could auction off the rights to frequencies to the highest bidder. The advantage of this method

would be that it tends to allocate frequencies to those individuals or firms which are most eager to have them and can use the frequency most efficiently and profitably. An added advantage would be to help reduce the Federal budget deficit through non-tax revenues gained from this unique form of asset sales.

The major disadvantage with auctions is that existing users have invested millions of dollars into equipment with the expectation of maintaining access to their frequencies. An alternative would be to award frequency rights through a lottery system, but this too might result in a tremendous waste of prior capital investment. If objections to those transfer mechanisms proved monumental, the FCC could simply award property rights to the current license holders. A marketplace for frequencies would then develop. This new market would allow entry for new firms that wished to buy frequency rights just as auctions would, but such a system would not penalize those users currently operating through government fiat.

But the particular mechanism for transferring control of the airwaves from the government to the private sector is not so important as the idea that the public would be best served by the introduction of a market for frequency rights. Only such a market could determine the most productive and efficient allocation of the spectrum.

The record shows that government regulation has been an affront to the principles of free speech and a detriment to society. Until we recognize property rights in broadcasting, that record seems destined never to change. □

1. Lucas Powe, *American Broadcasting and the First Amendment* (Berkeley: University of California Press, 1987), pp.12-23.
2. *Ibid.*, pp. 73-74.
3. "Broadcasting and the First Amendment," *Cato Policy Report*, Volume VI, Number 5 (May/June, 1984), p. 1 (italics in original).
4. *National Broadcasting Company* v. United States, 319 U.S. 554, at 219.
5. *Ibid.*, at 226.
6. Thomas Jefferson, letter to Colonel Edward Carrington, January 16, 1787, quoted in *Bartlett's Book of Familiar Quotations*, Fifteenth Edition (Boston: Little, Brown & Co., 1980), p. 388.
7. *Red Lion* v. *Federal Communications Commission*, 395 U.S. 367, at 378.
8. *Miami Herald* v. *Tornillo*, 418 U.S. 241, at 251.
9. *Ibid.*, at 256.
10. *Red Lion* v. *Federal Communications Commission*, 395 U.S. 367, at 388.
11. *Ibid.*, at 392.
12. *Miami Herald* v. *Tornillo*, 418 U.S. 241, at 254.
13. *Red Lion* v. *Federal Communications Commission*, 395 U.S. 367, at 386.

The Myth of Cultural Imperialism

by Robert K. Rauth, Jr.

What's faster than a speeding bullet, more powerful than a locomotive, and able to leap over hostile elitists in a single bound? Well, it's none other than the all-American duo of Mickey Mouse and Ronald McDonald.

It may come as a surprise to most Americans that overseas these beloved symbols are sometimes about as welcome as typhoid or leprosy. The cries of cultural imperialism are a relatively recent phenomenon. With the withering away of Western colonial empires, nationalists in the newly independent countries often became outraged over the staying power of colonial cultures. These nationalists came to term the presence and domination of Western culture as "cultural imperialism." Paul Harrison's description in his book *Inside the Third World* is typical: "And so there grew up, alongside political and economic imperialism, that more insidious form of control—cultural imperialism. It conquered not just the bodies, but the souls of its victims. . . ."

In time, the strength and attraction of Western popular culture became even more dominated by that of the United States. This development allowed the accusations of cultural imperialism to become just as common in European intellectual circles as in the Third World.

Because the French have traditionally been very proud of their culture, the emergence of American popular culture has been an especially bitter pill for them to swallow. The fear of encroaching Americana has often been on the mind of France's Minister of Culture, Jack Lang. Shortly after the Socialist Party's election Lang called "for a real crusade against . . . this financial and intellectual imperialism that no longer grabs territory . . . but grabs consciousness, ways of thinking, ways of living."

One of the people who have examined cultural imperialism most closely is the exiled Chilean author Ariel Dorfman. Dorfman has published two books on the subject: *How to Read Donald Duck: Imperialist Ideology in the Disney Comics* and *The Empire's Old Clothes: What the Lone Ranger, Babar, and Other Innocent Heroes Do to Our Minds*.

The case of Mr. Dorfman is important because he is so open about the elitism that the movement classically represents. Dorfman is extremely paternalistic toward the poor he has elected himself to represent. He proudly recounts one tale in which he tells a female slum dweller that photo novels, because they foster impossible dreams, are both "a hazard to her health and to her future."

Later we find that it is not photo novels that Dorfman opposes, but the fact that these books send the message that love and money can make one happy. We learn this because, soon after the socialist Allende regime took power, Mr. Dorfman was busying himself by becoming "personally involved in producing new comic books." Obviously, when it comes to Mr. Dorfman, the medium is not the message. As he later notes in *The Empire's Old Clothes,*

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"No matter whether a country is oozing with opulence or on the path to pauperdom, the new generation is always required to accept the status quo of their parents." Unfortunately, Mr. Dorfman never recognized the truism of this statement as he produced the new status quo for his children's generation.

The leftist bias of Dorfman and Lang is not unusual in those denouncing America's cultural exports. Dorfman believes working hard to achieve success is a myth the developed world is trying to perpetuate. (Does this mean he doesn't tell his children that hard work is the key to success?) This attitude is exemplified by his analysis of a Donald Duck cartoon. Dorfman mocks the moral of the story which he considered to be "the amount of money each person possesses is equal to the amount of work and cunning he has put into it." Dorfman is shocked that the cartoon ignores the "years of appropriating other people's labor to build up that wealth."

Uniting Against "Pollution"

The cries of cultural imperialism, however, are not restricted to the world's leftists. In fact, there are few issues that exact such a universal response from the world's elite, regardless of their political position. The left and right have often joined forces against the American "pollution" of their native culture. While leftists are disgusted by the strength and attraction of a base, capitalistic culture—one that emphasizes money, lust, and power—conservatives simultaneously lament the democratization of their "civilization."

One example of this coalition of strange bedfellows occurred recently in France, after the announcement that a European Disneyland would be built near Paris. According to one report, the French Communist Party joined "unreconstructed Gaullists in deploring the encroachment of an 'alien civilization' on a site so close to the 'city of enlightenment.' "

Despite the popularity of American food, music, fashion, and movies among the French middle class, the attacks on America's pop culture by French intellectuals have been particularly cutting. A popular magazine, *Le Nouvel Observateur* featured a cover with Mickey Mouse high above the Eiffel Tower. The headline read: "Is this Mouse Dangerous?" In the accompanying article, one writer likened Disneyland to a "degenerate utopia." One of the leading French newspapers, *Le Matin,* warned that the European Disneyland will "deform generations of French children."

Le Figaro's writers were equally outraged. Louis Pauwels called the coming of Mickey a "defeat for Europe." The most combative was Jean-Edern Hallier who cautioned against a "cellulite mentality" that would lead France to becoming "the 51st state after Hawaii."

This spectacle would have been amusing were it not so disarmingly hypocritical. After all, French rightists never complained about dispatching priests and bureaucrats to convert and civilize French West Africa. Similarly, French Marxists had few hesitations in proselytizing their own brand of religion to Francophobe subjects. As David Lamb, author of *The Africans,* writes: in French West Africa, France "remains the paramount economic and cultural force. . . . Unlike other colonial powers, France governed through a policy of assimilation or, as some have called it, cultural imperialism." This policy has not ended with the continent's independence, although French influence has slackened, much to the mother country's chagrin. Luigi Barzini, author of *The Europeans,* believes that France was the most dissappointed of any of the Western European powers at the loss of colonies and influence.

While condemnations of America's spreading influence are usually limited to the cultural sphere, a surprisingly large chunk of the opposition stems from the economic risks American firms pose to local inefficient enterprises. This economic insecurity further explains the left-right coalition. Workers represented by the left, and owner-managers represented by the right, fear American domination of their home market. In Canada for example, a top labor official fears that "free trade would turn us into bloody Americans." The same attitude is shared by many in Canada's broadcasting and publishing industries, where the link between culture and big business is especially important. Reactions to U.S. moves to open Brazil's computer market were no less fierce. Newspaper editorials were filled with charges of "U.S. imperialism" and Brazil's

foremost economic newspaper labeled American pressure "Rambonomics." Newspaper cartoons pictured President Reagan as Rambo, slamming Brazilian President José Sarney over the head with a computer.

Unions have also been particularly fierce in their fight against the first McDonald's in Mexico. This Mexico City McDonald's was accused of "threatening national values" mostly because it wanted to use part-time non-union workers. Protesters painted "Death to the Voracious Bosses" on the walls of the restaurant. The horrible crime of the nasty capitalist bosses? Paying non-union workers more in an hour than the union's standard contract paid in a full day. Meanwhile, cars backed up in a mile-long line waiting to order their Big Macs.

Which Culture Dominates?

The world's literati will be happy to know that America itself is not immune to the fear of cultural imperialism. Americans living between Los Angeles and New York often bemoan the cultural products of these two foreign capitals. More serious is the risk posed by what anthropologists term "the law of cultural dominance." This theory states that whichever culture is technologically superior will eventually dominate its inferiors.

Until World War II, this position of dominance was shared by Great Britain and France and was ceded to the United States in the wake of the war. If this theory holds true, perhaps the next dominant culture will be Japan's. As it is, Japanese food, fashion, and art are more popular than ever both in America and worldwide; Japanese technology and management techniques are in even greater demand. While this idea might seem a little far-fetched to some, it would surprise no one in the rust-belt cities of Detroit or Pittsburgh. Auto and steel executives speak openly of their hatred for their Oriental competitors, taking the phrase "trade war" literally. "This time," one auto executive told me, "the Japs won't lose."

At the moment, however, American culture is—if nothing else—technology, and it is in this realm that the fewest complaints abroad are heard about cultural imperialism. But vaccines, telephones, and airplanes are as symbolic of America as Mickey Mouse and Ronald McDonald. Once American technology is introduced—even though technology is generally considered non-imperialistic—a closer mirroring of America is likely to follow. For example, once cars become important to a society, road systems and cities designed to accommodate the vehicles will result. Thus, a more American-looking city is created. As a faster lifestyle comes about, fast-food restaurants such as McDonald's and Kentucky Fried Chicken become more acceptable and necessary.

This trend is especially well demonstrated by the success that these two chains have had in the rapidly developing Asian market. For example, McDonald's highest sales per store have been recorded in Taiwan while Kentucky Fried Chicken's most successful franchise is found in Malaysia. The chains admit that their success has been greatly dependent on these countries' economic development and urbanization.

The worldwide dominance of the English language is as much a result of America's intellectual and economic prowess as it is of the legacy of the British Empire. The majority of the world's foremost academics and businessmen use English; to communicate with them directly, or indirectly through their writings, one must be able to understand English. When Americans, with less than six per cent of the world's population, have won 38 per cent of all Nobel prizes in science, it should come as no surprise that Scandinavian graduate students in engineering use American texts. Similarly, France's premier graduate institute of business management has switched to an English format. As the dean of the school insists: "English is the international business language." What is the alternative for advocates of the theory of cultural imperialism? Should American professors be writing in French or Swahili?

American technical superiority also provides much of the basis for the omnipresence of our popular culture. American acting, writing, and designing is equal or superior to that of any European country. As for the technical side, Americans are without match. In fact, American music and film have become so well-

known for their production wizardry that there has been a home-grown backlash in favor of less polished projects. Critics have become bored with movies that contain more special effects than plot, and rock music has a large and growing movement that has embraced the raw energy of "garage bands."

Many would reject the law of cultural dominance. To them, the reason American culture is popular worldwide is due to the power of multinational corporations and their manipulative ad agencies. This view was succinctly stated by E. J. Dionne in *The New York Times*: "American culture is popular around the world . . . because it has behind it the enormous resources of a very rich country." But this is further evidence of the movement's elitism. If we are merely the puppets the elitists accuse us of being, we would all be drinking New Coke instead of Classic Coke (a fact that should be especially noted by those who describe cultural imperialism as the cocacolonialism of the world).

Rejecting Popular Culture

The ability to withstand America's popular culture is perhaps best illustrated by a community within shouting distance of America's megalopolis. A short distance northwest of Philadelphia lies a large community of Amish people living an eighteenth-century lifestyle. They have been able to reject T-shirts and television, and have prospered, thus proving that not only is it possible to steer clear of twentieth-century pop culture, but that acceptance of it is not necessary to thrive economically.

The power of advertising is not an omnipotent one. As even Ariel Dorfman realizes, "There is in men and women a deep refusal to be manipulated." Sixty per cent of all grocery products test-marketed fail in America despite the millions of dollars targeted for advertising. Conversely, many important recent musical movements, such as punk, acid rock, and disco, were popular long before they were noticed by radio stations and record companies. Moreover, without the influence of Madison Avenue in the Soviet Union, how can one explain the popularity of Levi's and rock music in that country?

A more plausible explanation for the success of American popular culture abroad has been offered by a French writer, Pierre Billard, who hypothesized a melting-pot theory. As a nation of immigrants, the United States has absorbed talent from all over the world and has synthesized it into a universally accepted culture. In doing so, columnist Richard Reeves states, "the world's great democracy has produced the great democratic culture. It may be the 'lowest common denominator' entertainment, but that's just another way of saying 'universal.' "

The immigrant can be found from the beginning of America's—and therefore the world's—popular culture. Popular culture was born only in the last 100 years, during the height of the immigration influx. Because of the huge numbers of disparate peoples with little knowledge of English, the purveyors of the new culture were forced into simplicity. Kurt Anderson of *Time* points out that comics were pushed by newspaper magnates Pulitzer and Hearst "to appeal to readers freshly or barely fluent in English. Vaudeville was a spangly folk theater of bold strokes that had to entertain first- and second-generation Americans."

This simplicity has, however, provided the elitists with much of their ammunition. One French writer, for example, likened the diffusion of American culture to the Continent as the "cretinization of Europe."

This tradition of simplicity has continued with Westerns, war movies, and police flicks. These movies have been welcomed overseas largely because they are action-filled and thus better understood by people in foreign countries. (Of course, Hollywood has no monopoly on thrillers. Karate films from Hong Kong and Singapore do a bang-up business throughout the Third World. Indian films, which are generally romantic melodramas, do well because the actors use hugely exaggerated gestures better to tell the story. Despite the success Indian romances have had around the world, no one complains about Indian cultural imperialism.)

Another reason that these films do well is because they are created for mass audiences. As French actor-singer Yves Montand, a former Communist sympathizer turned Reagan-admirer comments: "If America has succeeded

in invading us culturally, it is because we like it. T-shirts, jeans, hamburgers: Nobody imposes these things on us. We like them." In contrast, countries such as France and West Germany spend a large part of their cultural budget producing films and T.V. programs that aspire to be "art." Critic Jacques Barzun comments that this strategy has failed: "The French experience of 300 years is conclusive. In France, those who produced the works we admire today, had to survive as best they could, outside of officialdom and often in angry opposition to it. By contrast, the term 'official art' means art that is competent and safe."

Furthermore, as any free-market advocate would be quick to point out, government projects naturally tend toward inefficiency and ineffectiveness. Thus any government-sponsored program faces double the struggle that any private production would not only in becoming art, but in attaining popularity.

Perhaps one of the most ignored factors behind the attractiveness and quality of America's cultural exports is that they are made in a free environment. Why would a creative Eastern European or Latin American risk producing a movie or album only to have it censored? Maybe one of the reasons literature flourishes in these two regions is because it is one of the few art forms that is a private accomplishment and can be easily hidden.

The perils of censorship of the arts are well illustrated by the history of the Mexican movie industry. Mexican film, according to journalist Alan Riding, experienced a golden era in the late '30s and early '40s. This rise to prominence was recognized throughout Latin America and occurred because Hollywood movies became more concerned with propaganda and less with entertainment.

This gilded age ended in the '50s when the Mexican government bought out the nation's largest studio, and eventually came to own most of the movie theaters and the Cinematographic Bank—which provides financing for most productions. Riding concludes that soon after, "The low quality of the movies exhibited in Mexico . . . reflected the government's fear of political and moral subversion. Censorship remained tight, with only cheap and banal entertainment considered appropriate for the masses." This situation has been altered only since 1970-1976 when the Mexican government eased control and allowed the production of a number of movies that were both critically acclaimed and box-office hits.

Argentine films have been similarly transformed in recent years. As one observer notes, "every time a democratic government assumes power in Argentina, the number of films increases—greater freedom releases creative talent. Financial problems are overcome and international recognition follows," as evidenced by the Oscar-winning *The Official Story*. Obviously, a foreign culture has a much better chance to dominate when local artists are inhibited.

While radio, T.V., and film are often railed against as instruments of American cultural imperialism, the vast majority of governments show little restraint in using the media to further their own interests. The Soviets encourage outer space exploration and development of Siberia through music and film. A song by one government-sanctioned rock group is entitled "I'll Take You Away to the Tundra." This strategy is shared by non-Marxist governments as well. One Mexican politico argues that popular culture should be used to contribute to stability by diverting attention from social problems: "It's better to use tearjerkers than tear gas."

Cultural Imperialism in Miami

One of the best environments to examine cultural imperialism lies not in Western Europe or the Third World but in Miami, Florida. Anglos and blacks in that city are tireless in voicing their objections to Hispanic cultural imperialism. As one bumper sticker states: "Will the Last American to Leave Miami Please Bring the Flag." With 40 per cent of the city's population Hispanic, non-Hispanics often feel like strangers in their own country. They point to Miami's two Spanish-language newspapers, two television stations, six radio stations, and the political domination of Hispanics. They are especially incensed that Miami residents increasingly need to master two languages—an obstacle that has particularly hampered black employment opportunities. For instance, a re-

cent discrimination complaint was filed by two Miami women who were refused jobs as cleaning women in a downtown office building because they couldn't speak Spanish.

It is not difficult to relate to the problems of non-Hispanics in Miami. But a closer investigation yields a different conclusion on cultural imperialism in Miami. What is taking place in Southern Florida is a hybridization of Hispanic and non-Hispanic cultures: evidence that cultures are dynamic, making the history of cultures a history of evolution. Cultures are adaptive, and as the needs of a society change, the culture is altered.

The most conclusive evidence supporting this theory is the alacrity with which Cubans in Miami have accepted the American dream. With the help of Cuban-immigrant entrepreneurs, a dying port and travel destination has once again become a boom town. Equally important, for better or worse, Hispanic lifestyles are mimicking their Anglo counterparts. The vast majority of Cubans in Florida have learned English, are relatively well-educated, and for those between the ages of 25 and 34, earn a higher median family income than their non-Hispanic white peers. Despite their staunch Catholicism, the Cuban divorce rate matches the U.S. national average and their birthrate falls just below the national average. Finally, and perhaps most significantly, approximately half of all Cuban women marry non-Hispanic men. Older Cubans resent the Americanization of the younger generation nearly as much as Anglos and blacks grumble about the Hispanic influence in Miami.

What all of this means is that America is as subject to foreign influences as other countries are. Americans do not suffer, but enjoy, Jamaican reggae, Chinese restaurants, and British comedy. As evidenced by the difficulties in Miami, hybridization of cultures is not always easy. But those who denounce America's cultural imperialism should realize that closing a society is no solution to preventing outside influences. The most insular societies have the least to offer culturally to the masses. Despite its claim to the world's proletariat, it is ironic that the Soviet Union's most vital cultural export—ballet—has not been appreciated by the masses, but by the world's elite.

A Classless Phenomenon

Strangely enough, popular culture, the child of capitalism, is a largely classless phenomenon. As Kurt Anderson astutely observes, "Unlike serious painting or dance or poetry, the appreciation of popular culture requires no tutelage or special sensibility, not even close attention. Florenz Ziegfeld and George Lucas create art that is one-size-fits-all. Except perhaps for Roman Catholicism, no other Western cultural genus has been as inclusive as modern pop, so truly classless." Perhaps only Levi's and Elvis Presley can fulfill the dream that Lenin and Marx desired. In contrast, with the exception of an occasional gymnast or trapeze artist, modern popular Soviet culture is a wasteland.

It is not surprising that the most open society on earth has the most attractive popular culture. Just as a protected market leads to less competition and fewer innovations, an open market—whether economic or cultural—is bound to be more dynamic. After all, capitalism is exceedingly efficient in giving society what it wants. No one is surprised to learn that New York City is more vigorous culturally than Moscow. What nationalistic elites must realize is that along with the good, an open society may be subject to some dislikable elements. But a closed society brings in nothing—it is dead.

Most of us would regret the homogenization and standardization of the world. After all, finding a McDonald's in Katmandu would make that town a little less exotic and special. But who are we to tell them that they shouldn't have a McDonald's? Let their wallets decide. □

Bringing the Pirates to Bay

by Gary McGath

Ten years ago, hardly anyone had heard of software piracy. Today, it is a household word and a household crime. People who wouldn't think of sneaking merchandise out of a store or burgling a house regularly obtain copies of computer programs which they haven't paid for. Why does this happen, and what is necessary to stop it?

If we consider "software" in a broad sense, the problem goes beyond computer programs. The same issues and the same psychology arise in obtaining unpurchased copies of audio and video recordings. Software, in this more general sense, means any kind of information stored in a form which can be readily copied.

There are two kinds of software pirates: hobbyists and business users. Hobbyists go largely after computer games and often obtain copies of virtually every game available. Business pirates acquire copies of high-priced business software. Sometimes they get all the free copies they want from an accomplice, and sometimes they buy one copy of a program and then copy it onto every computer they own. The business pirates are undoubtedly the more harmful in terms of economic impact on software producers.

Software publishers often try to protect themselves by means of copy protection and "shrink-wrap" license agreements. Neither method has proved effective. Copy protection consists of modifying the program disk so that it physically cannot be copied. Such schemes can always be overcome, and legitimate users are injured by being unable to make a back-up copy against the failure of the original disk, or a copy to the hard disk which stores all their programs.

"Shrink-wrap" licenses are terms of use which are enclosed with the package, and which the publisher asserts the user has agreed to by opening the package. But these licenses have not been thoroughly tested by the courts, and in any event are useless against pirates who aren't caught. Very few pirates are caught.

The software pirate has a ready set of excuses for his actions: prices are too high; the company doesn't provide decent support; I'm only going to use it once in a while. But the distinguishing feature of software, which allows its theft to seem less bad than other kinds of theft, is that nothing is physically taken from the owner. There is no immediate, physical effect on the inventory or productive capacity of the creator of a piece of software if someone 500 miles away copies a disk and starts using it.

There is, of course, a cumulative economic effect on the producer. The more people make unauthorized copies, the fewer copies tend to be sold, and the less money the producer receives for his effort and expense. But pirates often rationalize that they wouldn't have bought the program anyway, so they aren't cutting into the producer's revenue.

The attitude of software pirates is partly due to the widespread hostility to property rights in today's culture, but more specifically due to a misunderstanding of the nature of those rights. To the average person, property is primarily or

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exclusively material in nature. A piece of property is a physical thing, such as a kettle, a car, or a plot of land. A computer program or a recorded performance is not a physical thing, hence it does not appear so clearly to be property.

But property is not a concept pertaining to matter alone. There is no purely physical fact, unrelated to the human mind, which corresponds to ownership. Possession is not the same as ownership; if someone breaks into my car and drives away with it, I am still its owner even though the thief has seized possession.

Principles of Ownership

Ownership is a concept pertaining to a just mode of interaction among human beings, and it arises out of the fact that people live by creating things of value for their own use or for trade with others. Creation, in this sense, does not mean bringing matter into existence, but rather changing the form of matter in accordance with an idea and a purpose. It is the idea, not the object, which a person actually brings into existence when he creates. By conceiving of a particular arrangement of matter and reducing that concept to practice, a person creates something which he can use directly for his own purposes, or which he can offer to others in exchange for what he needs.

Most commonly, the actual cost of this process is concentrated in the production of individual items. Designing a good chair does take a certain amount of time, effort, and cost in materials, but the major part of the cost lies in the production of each chair. With software, the reverse is true; the cost of producing copies is negligible compared with the cost of devising the form of the product.

In both cases, though, the only way a producer can benefit from offering his product in trade is for others to respect his right to it and to obtain it only on his terms. A person may have other reasons for distributing software than expectation of payment, and there is in fact a large amount of legitimately free software available; but if people are going to make the production of software a full-time occupation, they must and should expect a return for their efforts from the people who benefit thereby. If they do not receive a return, they will have to switch to a different sort of activity if they want to keep eating.

But what does this mean to the would-be user of software? The producer's problem is not his; should he concern himself with whether the programmers at Microsoft will be laid off or the owners of Podunk Programming will go out of business? With most kinds of theft, the likelihood of punishment provides a specific deterrent to taking other people's products without payment; the risk of such penalties is negligible for software thieves. The likelihood that a given pirate's actions will break a software company, and thus injure the pirate, is also negligible.

Risk of peer disapproval is potentially a more effective factor. However, with moral uncertainty being the watchword of the day, most people simply will look the other way when a person steals a program; pirates can even bring up their actions in normal conversation without much fear of disapproval.

In some cases, employers even feel that they can intimidate employees into becoming their accomplices. An anonymous letter in *MacWorld* magazine stated, "I recently had a nasty experience with my boss when I refused to make him a copy of *Works* [a program for the Macintosh computer], which I'd bought for my own use. (He later got a copy from another employee.)"

But there is a more basic deterrent to theft than the risk of getting caught or of suffering disapproval. A person can fake what he is to others, but not to himself. A person cannot escape the knowledge of whether his existence is sustained by his own efforts, or whether he is a dependent who relies on the productive ability of others and on their blindness to the fact that he is living off them.

I am not speaking here of conscience—there are people who apparently have none—but of something even more fundamental, self-knowledge. The person who steals, or who gains admiration by lies, or who obtains his living through a do-nothing job, is inevitably aware that he is living not by his own efforts, but by someone else's, and that he must rely on other people's ignorance of his act in order to maintain this state of affairs; or if he avoids this

knowledge, he does so only by severely curtailing his ability to recognize reality. Such a person cannot escape the sense of being out of place in the world, since he maintains an antagonistic relationship toward those who benefit him.

Seeking Rationalization for Theft

The evidence for this lies in the fact that thieves, and software pirates in particular, always seek rationalizations for their actions. Muggers try to think of their victims as despicable enemies; politicians imagine that they are serving the "greater good"; and software pirates say that the product is overpriced or that a true hacker would work solely for the pleasure of programming. Some may make peace with their excuses, bolstering their sense of self-sufficiency with a prop made out of ignorance; others will realize in the back of their minds that they have what they have only through the folly of others and will wonder why they always resent people's success. In either case, self-knowledge becomes a danger to them.

Thieves who abandon the pretense of honesty often fall back on the pretense of being smart: "It's stupid to buy something when you can just take it." They attempt to see themselves as attaining their goals by being more clever than the people who buy, and thus as existing by their own wits in the sense of avoiding costs and evading detection. But this is also a pretense; they know, unless they work at shutting down their minds, that their own "cleverness" works only because of the "stupidity" of others who pay for what they buy and who don't notice or care about the thieves. They are counting on the failure of the very people whose successful efforts they use.

(This needs some clarification; a person who makes a living by understanding some phenomenon better than others is not dependent on their lack of knowledge in this way. A doctor who treats people for injuries they incurred through ignorance is benefiting from their belated intelligence in seeking to solve their problem; he is not relying on their *continuing* failure to recognize reality. In contrast, a doctor who urged his patients to continue being reckless so that he could treat them again would be actively promoting stupidity, and would be entering an adversarial relationship with the people providing him with a living. Software pirates likewise depend on publishers' and honest users' continuing ignorance of or indifference to their actions, and are threatened rather than benefited when people catch on to their mistakes.)

The best defense against software piracy lies neither in physical hindrances to copying nor in stiffer penalties. The first have been shown to be ineffective in preventing theft and inconvenient to legitimate users. The second are useless if the pirates won't be caught anyway. The primary deterrent to theft in stores—at least in the more peaceful neighborhoods—isn't the presence of guards and magnetic detectors, but the fact that most people have no desire to steal. The best way to stop piracy is to instill a similar frame of mind among software users. This means breaking down the web of excuses by which pirates justify their actions, and leaving them to recognize what they are. Ultimately, this is the most important defense against any violation of people's rights; without an honest majority, no amount of effort by the police will be effective. □

Alfred North Whitehead

IDEAS ON LIBERTY

Without a society in which life and property are to some extent secure, existence can continue only at the lower levels—you cannot have a good life for those you love, nor can you devote your energies to life on a higher level.

Leave DAT Alone

by Carl Clegg

Digital audio has made brisk strides during the past decade. Compact disc (CD) technology, in particular, has gained a large share of the American music market. But the wave of the future may very well be digital audio tape (DAT).

DAT has a lot to offer. Already standardized, DAT recorders are sold in Japan, and on a limited basis, in Europe. The DAT cassette—about half the size of a conventional analog cassette—can store two hours of CD-quality music. Similar arrangements of digitally stored bits and bytes account for the ultra-high fidelity of both DAT and CD formats. The principal advantage of the DAT recorder over the CD player, however, is recordability. This very asset, in fact, is responsible for the current ban in the United States on DAT technology.

The impetus behind the DAT embargo is an effort to appease the prerecorded-music industry. Their chief concern is that bootlegging will cut into their profits. While their concern is legitimate, their solution is not.

The record industry is advocating laws which would coerce DAT manufacturers into equipping each DAT recorder with a copy-code chip. These chips would inhibit the recording of specially encoded CDs or, for that matter, any encoded medium, including prerecorded DAT cassettes.

Record-company executives contend that DAT would be an open invitation to piracy—a violation of musicians' property rights. In reality, however, the copy-code chip would violate consumers' rights to make copies for personal use.

The same laws which prohibit unauthorized reproduction of published material also prohibit bootlegging of prerecorded music. The "fair use" clause of the Federal copyright law permits reproduction of copyrighted works for educational and noncommercial purposes. Likewise, the law permits consumers to duplicate prerecorded music for personal use only.

It seems reasonable that if someone buys an LP or CD, he should have the right to make a tape copy to play back on his Walkman, in his car, or, for that matter, on his DATman. Here, the law agrees. There is, therefore, a glaring contradiction: on one hand, the consumer has the right to make home copies for personal use; on the other hand, the proposed copy-code law would prevent him from exercising that right.

The copy-code argument is fallacious for another reason: the law would be unenforceable. Historically, technophiles have responded to any mechanical device that annoys them. (This, of course, is not to say that what they do is always legal or moral.) Their answer to the radar trap was the radar dectector; their answer to scrambled video signals is the descrambler; their answer to the copy-code chip would come soon after the enactment of the copy-code law. Any law, such as the copy-code law, which is widely viewed as unfair and is easily circumvented, breeds disrespect for all law.

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Just as Prohibition moved liquor businesses underground, the current DAT embargo has created a plethora of unauthorized "dealers." If one has the right connections and is willing to deal with a back-alley swindler, it is possible to buy a DAT recorder in the United States.

Proponents of the copy-code law claim they are defending the property rights of musicians. It seems clear, however, that record labels are more concerned with their own sales than with the rights of artists. In fact, the implications of the copy-code proposal actually offend the artist because encoded music suffers sonic degradation. The artist's music never reaches the consumer's ear in a pure form.

The high resolution of the CD offers the closest replication of "live" music. Critical listeners, however, who have performed comparison tests between coded and uncoded music, claim that the encoding is annoyingly obvious and seriously detracts from the quality of prerecorded music. A Gallup poll showed that even the untrained ear can detect encoded music. Since all prerecorded music (and presumably, radio broadcasts, too) would be encoded, virtually everyone would suffer, not just the DAT owners.

Consumers as Criminals

One of the most offensive inferences of the copy-code proposal is the presumption that all potential DAT consumers are criminals. Those most offended, of course, are home-recording buffs—those who enjoy recording not prerecorded music, but their own creations. Under the copy-code law, anyone wishing to purchase a DAT recorder would be forced to buy a copy-code chip—an accessory he probably doesn't want and shouldn't be forced to buy.

Perhaps record company executives should take a retrospective look at the conventional analog cassette. When it first became popular, the cassette was feared by record companies as a means for copy-pirates to poach music from LPs. Today, prerecorded tape sales—especially with the advent of the Walkman—exceed the sales of LPs and CDs combined. Since a prerecorded DAT tape would sound at least as good as a CD, record companies may be working against themselves by crippling a future market.

One way to deal with the problem of DAT piracy might be a stiff penalty for criminal trafficking of pirated tapes. We also should look to the free market to generate its own solutions. The personal computer industry, for example, has done amazingly well without the "help" of anti-copying chips (which, a few years back, were thought to be essential). Software companies, in an effort to discourage unauthorized copying, reward paying customers by offering manuals, future revisions, and in many cases, telephone trouble-shooting, at little or no extra cost.

Record companies need to show more initiative. One record company, for example, has addressed the dilemma of multiple formats by offering a cassette copy with the purchase of each CD. Far-sighted companies will spend more resources on producing prerecorded DAT tapes, instead of trying to ban and devitalize DAT. Consumers would have no need to copy CDs if their favorite music were available on DAT. The best approach to progress is not to resist it, but to adapt to it. □

John Stuart Mill

IDEAS ON LIBERTY

The only freedom which deserves the name, is that of pursuing our own good in our own way, so long as we do not attempt to deprive others of theirs, or impede their efforts to obtain it.

Privatization at the State and Local Level

by Donald Grunewald

Recently, I had the occasion to visit a domestic airline terminal in the United Kingdom. I was struck by the many improvements since my last visit to the same terminal four years earlier. It was cleaner and there were more amenities—several places to eat, an efficient luggage area, and even comfortable seating in the waiting area including seats one could lie down on if a plane were late.

When I inquired what had caused the change, I was told that the airports had been privatized by the Thatcher government—they are now in the private sector. Under private ownership, there is an incentive to provide better services to travelers. The profit motive works, especially when freed from the burden of a large bureaucratic public airport authority where no one seems to care about the traveler.

Since privatization of airports works in the United Kingdom, why not try it here? Imagine New York's La Guardia Airport, for example, with travelers permitted to pay for parking via credit cards or with people-movers that actually were in operation to ease carrying baggage from the parking garage to the terminal. Privatization of our airport terminals through a sale of common stock would have the added benefit of permitting repayment of some bond issues, resulting in lower effective taxation to the general public which now pays for such facilities.

Privatization could well be extended to other areas of state and local authority. Privatization of public housing projects (this is being done now in the United Kingdom) through sale to tenants via cooperative or condominium ownership would lead to improved housing. Tenant owners would take more care of their apartments and common areas than do tenants in public housing.

Privatization also could be extended to public higher education. Many of our public colleges of higher education are agglomerated into large systems with an extensive bureaucracy which spends much of its time and energy coordinating turf issues and handing out political patronage at the direction of local politicians.

For example, the City University of New York system has twenty presidents as well as many central officials such as a chancellor and a plethora of vice chancellors, assistant vice chancellors, and so on. If the City University were privatized into one or two independent institutions for each borough of New York, the entire central bureaucracy could be eliminated and much of the bureaucracy caused by the excess number of units could be done away with. The funds saved could be used to improve the quality of education, thus reducing the number of dropouts and enabling more graduates to read and write the English language. Hiring presidents on the Tammany system of dividing the jobs up by ethnic, religious, and other influences could be replaced by hiring presidents on the basis of merit.

Privatization of public systems of higher education could take two forms. Public colleges

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could be converted into institutions like independent private colleges which tend to be more cost effective and less subject to improper political influences. Alternatively, some of the public colleges could be privatized as proprietary institutions—with proceeds of sales of stock being used to help pay off the debt obligations of the public system. Proprietary higher education can be of high quality, as has been proven by such institutions as the School of Visual Arts in New York or the Arthur D. Little Management Institute in Massachusetts.

Privatization of some other institutions, such as hospitals, is already taking place in some areas of the country. Such privatization at the state and local levels will benefit the public by improving the quality of the services. Owners will take better care of the properties involved and have more incentive to provide good service to users. Privatization also can improve the economic efficiency of such institutions as airports, housing, colleges, and hospitals because of the profit motive and through a reduction of politicization (such as hiring administrators for political reasons) and a reduction in bloated and overpaid bureaucracies.

Privatization of such institutions has worked in the United Kingdom and elsewhere. It should be tried here. □

Free Needles

IDEAS ON LIBERTY

New York City officials have decided to distribute clean needles to intravenous drug users to combat the spread of AIDS. Will the program work? Dean Herbert London of New York University, writing in the March 1988 issue of *The London Letter,* expresses a healthy skepticism:

"When it comes to the government's AIDS initiatives, it is useful to recall what happens when the government gives anything away. We know, or should know that the blankets given to the so-called homeless are now sold at open bazaars in many city locations, and that city distributed methadone is sold by addicts to other addicts. Might not there be an underground market for the sale of government distributed needles too?

"Give-away programs can be counted on to spawn problems both practical and ethical. Drug companies are about to be forced into the unethical practice of distributing hypodermic needles. With needles distributed freely, under government supervision, it can be safely predicted there will soon be complaints of below par quality and supply shortages. But this will be only the beginning. It is almost inescapable that a suit will be brought against the state for promoting drug use or, if an addict dies of an overdose after using drugs in a hypodermic needle, charges of manslaughter. It can also be anticipated that if this program becomes part of the landscape of government assistance activities, at some time in the future the public will be entertained by a procurement kickback scandal in which one or more politicians will be indicted for taking bribes. There will be much talk of declining moral standards from editorial writers, even though the outcome should have been foreseeable by anyone familiar with the history of government give-away programs.

"Even if one rejects the moral argument against needle distribution, there is still the irrationality of yet another government give-away program that is inherently inefficient. The additional cost of several pennies for clean needles to drug users who spend several dollars getting high, is not unreasonable. If drug users wish to survive—a highly dubious proposition in the first place—the investment of several pennies for clean needles shouldn't be an exorbitant price to pay, nor should it be the responsibility of government to provide them."

A REVIEWER'S NOTEBOOK

Educating for Virtue

by John Chamberlain

People who talk about educating for virtue are prone to be didactic and preachy. One distrusts them as being Holier Than Thou. Fortunately, Joseph Baldacchino in his *Economics and the Moral Order* (National Humanities Institute, 426 C Street NE, Washington, DC 20002, 43 pp., $4.00) and the contributors he has assembled for another book, *Educating for Virtue* (National Humanities Institute, 114 pp., $5.00) are wary of pitfalls.

Russell Kirk sets the tone in his introduction to the Baldacchino book and in the separate essay he has done for *Educating for Virtue*. He is humorous about it all. He is not an enemy of economics, but he doesn't think economics is everything. We need a moral setting for a free market system. Kirk would call Ludwig von Mises a giant of free market theory, but he thinks Mises must be supplemented by a look at Wilhelm Roepke of Geneva. He tells the story of the Mises visit to Roepke after World War II. Roepke showed his visitor the garden plots that citizens of Geneva had planted as a food supplement both in the war and after. Mises shook his head. "A very inefficient way of producing foodstuffs," he said. "But," so Roepke replied, "perhaps a very efficient way of producing human happiness."

Economic productivity is made for man, says Kirk. A free and prosperous economy is the by-product, so to speak, of a society influenced by sound moral principles and accustomed to good moral habits. The Ten Commandments are important, no matter what the individual may think about Biblical revelation. When societies cease to honor their forebears and engage in falsehoods and adultery, decadence sets in. One does not have to be preachy about that. The common sense attitude expressed by Willi Schlamm, who said he believed in the Ten Commandments and Mozart, is enough.

Some of the essays in *Educating for Virtue* tend to be ponderous with high level abstractions. I could do without hearing about epistemology, which always sends me to the dictionary. But two essays, Peter Stanlis's "The Humanities in Secondary Education" and Solveig Eggerz's "Permanence and the History Curriculum," are blessedly concrete. So are the paragraphs on Secretary of Education William Bennett in Russell Kirk's essay. Bennett, says Kirk, "is sufficiently bold to recommend that young people learn about traits of character by acquaintance with the literature of the Bible; he mentions 'Ruth's loyalty to Naomi, Joseph's forgiveness of his brothers, Jonathan's friendship with David, the Good Samaritan's kindness toward a stranger. . . .' "

Peter Stanlis takes as "an archetypal model" the freshman survey of English literature taught at Middlebury College in Vermont during the 1940s. He thinks the Middlebury course could be adapted for limited high school use. The Middlebury survey began with selective essential literature from Beowulf through Thomas Hardy. There were three plays by Shakespeare,

DOVER PUBLICATIONS

Joseph and his brothers

a history, a tragedy, and a comedy. For biography the Middlebury students read Boswell on Samuel Johnson. For fiction there was Fielding's *Joseph Andrews* for the eighteenth century, Dicken's *Great Expectations* for the nineteenth, and Virginia Woolf's *To the Lighthouse* for the twentieth.

Tales that Teach

Stanlis thinks that students who begin with imaginative literature in grade school, starting with Mother Goose and Robert Louis Stevenson's *A Child's Garden of Verses,* with a follow-up of Grimm's fairy tales and Aesop's fables, are sufficiently well-prepared to handle more demanding literature in their junior year in high school. He suggests cross-fertilization courses in English and European history. The survey course in English literature should not be in literary history, but in literary criticism of assigned plays, poems, and fiction.

The exposure of students to the whole range of literature must contribute to virtue simply because the examples in stories make their own points. Lady Macbeth and her husband came to no good end.

The setting for the humanities must be history. Solveig Eggerz laments that history has not only lost its place in the schools but "has been cannibalized by social studies." Since social studies can be anything an individual teacher might be interested in pushing (psychology, sociology, anthropology, or whatnot) there is no compulsion for students to learn about significant dates. They can and do emerge from school with no valuable frame of historical reference. "In the name of relevance," Eggerz says, "students immerse themselves not in the causes of the fall of the Roman Empire, or in the ideas that inspired the Renaissance, or in the build up to and the consequences of the French Revolution, but in energy education, gun-control education, urban studies. You name it. Social studies has got it—or can order it for you."

One book in common use dismisses the Age of Exploration with a few perfunctory words about the use of the compass. "One can only lament, says Eggerz, "The absence of . . . exciting stories on Ferdinand Magellan, Francis Drake . . . the Spanish Armada."

Clearly, much needs to be done to bring education back to schooling. □

COMPASSION VERSUS GUILT AND OTHER ESSAYS

by Thomas Sowell

William Morrow and Co., Inc., 105 Madison Ave., New York, N.Y. 10016 • 1987 • 246 pages • $15.95 cloth

Reviewed by David M. Stewart

"When a political crusade is on, there is no time to wait and see if anybody knows what they are talking about." To anyone who has followed only Thomas Sowell's scholarly writings over the last decade, such a bald and sardonic comment may seem a bit out of character in tone, though not at all in content. With meticulous scholarship, Sowell's works of the 1980s, beginning with the brilliant and seminal *Knowledge and Decisions,* have unraveled the verbal veils in which activists, academics, and politicians have clothed so many factually shallow and logically absurd theories and policies.

But Sowell's latest book is a collection of powerful broadsides, originally published as newspaper columns. The language here is blunter, the arguments terse and less courteous, the overall effect more scathing—and very emotionally satisfying.

Most of the essays in *Compassion versus Guilt* are, in effect, popular treatments of the philosophical themes set out in Sowell's previous book, *A Conflict of Visions*. In that work he posited a dichotomy between "constrained" and "unconstrained" visions of man's moral and mental natures and capacities. The constrained vision holds social change as something to be approached cautiously because of the intractable limitations of human morality and knowledge. The unconstrained view holds social change as directly manageable, at least by a selfless and enlightened few.

In this book, Sowell takes a side—the constrained side. The most frequent target of his barbs are "deep thinkers," people whose credo has such items as: by eliminating high standards we can eliminate failure; people are entitled to welfare in preference to "menial" work; only political and bureaucratic jobs are noble and valuable; sex education is the solution to the teen pregnancy problem; affirmative action is good despite the opposition of its supposed beneficiaries; and so on. Sowell is at his polemical best when he shows the contortions his opponents must perform to sustain these views in the face of their absurd or disastrous implications and results.

Thomas Sowell's works provide lovers of liberty with a vast store of careful logic and illuminating facts that can help us change minds and even policies. But most of us must make our arguments for liberty in situations that demand brevity—letters to editors, private conversations, local meetings, and the like. These essays show that issues can be dealt with briefly yet trenchantly, with respect for facts and with explosive effect on statist arguments. □

Mr. Stewart is an advertising copywriter and a free-lance writer in Rochester Hills, Michigan.

LUDWIG VON MISES: SCHOLAR, CREATOR, HERO

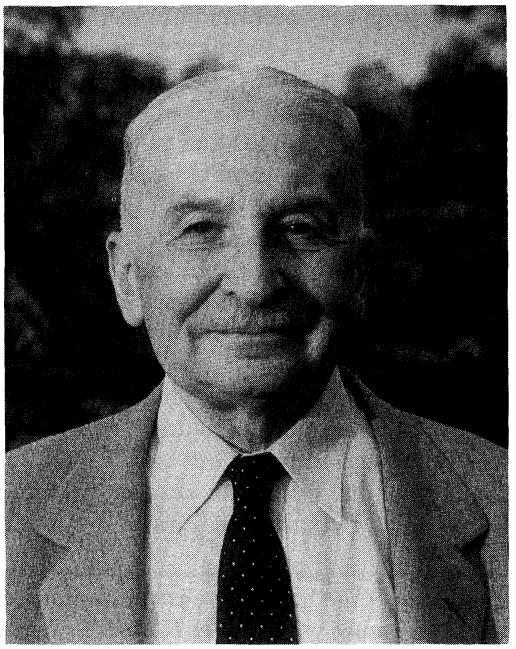
by Murray N. Rothbard

The Ludwig von Mises Institute, Auburn University, Auburn, Alabama 36849 • 1988 • 87 pp., $8.00 paperback. Also available from The Foundation for Economic Education.

Reviewed by Bettina Bien Greaves

The great Austrian economist, Ludwig von Mises, died in 1973. A generation of young students has come of age since then. These new students know Mises only by name and through his reputation as an advocate of free markets. Although they could not know Mises personally, they are fortunate in having available a growing volume of literature about him and the economic theories he expounded.

Several books have been written about Mises' life—for instance, his own *Notes and Recollections* (published posthumously in 1978) and his widow's *My Years with Ludwig von Mises* (1976 and 1984). *The Essential von Mises* (1973) by Professor Murray N. Rothbard, reprinted in the 4th edition of Mises' *Planning for Freedom* (1980), gives a brief introduction to the man and his work. But now



Ludwig von Mises
(1881–1973)

this new booklet, also by Professor Rothbard, gives an excellent, slightly longer, overview of the high points in Professor Mises' life and of his major contributions to economics.

For several years, when Rothbard was working for his doctorate at Columbia University, he was an active participant in Mises' graduate seminar at New York University. He knew Mises well. And he understands the economics Mises taught as few others do.

In this booklet, Rothbard tells of Mises' early life in Austria and of his career as a teacher and as an economic adviser to the Austrian government. He describes two of Mises' major books published during those years—*The Theory of Money and Credit* (1912) and *Socialism* (1922). Rothbard tells about Mises' private seminar, attended by such notables as F. A. Hayek, and he discusses Mises' struggles in Vienna against inflationists, socialists, and communists.

When Mises realized that the situation in Austria was hopeless, he left his native country for Switzerland. There he spent several years (1934-1940) teaching and writing. Among other works, he wrote a weighty and important economic treatise, *Nationaloekonomie,* which was published in 1940. Hitler was then riding high in Europe. Few readers of German were in a position to study the economic theory of free markets at that time, so the sales of Mises' books were disappointing.

To escape the catastrophe in Europe, Mises left Switzerland. He arrived in the United States in 1940 with his wife and immediately began to carve out a new career for himself, lecturing and writing in English. In the remaining three decades of his life, he wrote six books, including his magnum opus, *Human Action,* a complete rewrite in English of his ill-fated *Nationaloekonomie.* He also wrote several monographs and many articles.

In this booklet, Rothbard briefly explains Mises' epistemology—the fundamental principles from which Mises reasoned. Rothbard also summarizes Mises' most important contributions to the theory of money and banking, the causes of the business "cycle," and the reasons why economic calculation is impossible under socialism.

Mises' understanding of the consequences of government intervention made him a pessimist for most of his life. Yet he never gave up. He met every danger, Rothbard writes, with "magnificent courage . . . no matter how desperate the circumstance." Whether he was battling inflation, socialism, government intervention, or Nazism, "Ludwig von Mises carried the fight forward, and deepened and expanded his great contributions to economics and to all the disciplines of human action."

Rothbard gives the reader a good, if abbreviated, introduction to Ludwig von Mises, his life, his character, and his work. This booklet will interest both the novice and the serious scholar. □

Mrs. Greaves is a member of the senior staff of The Foundation for Economic Education. From 1951 to 1969 she was a regular participant in Ludwig von Mises' graduate seminar in economic theory at New York University.

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Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Thomas C. Stevens, chairman; Ridgway K. Foley, Jr., vice-chairman; Paul L. Poirot, secretary; H.F. Langenberg, treasurer.

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Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

The Freeman considers unsolicited editorial submissions, but they must be accompanied by a stamped, self-addressed envelope. Our author's guide is available on request.

PERSPECTIVE

Freedom's Child

Walter and I were very lucky. Our *babunia* (grandmother) never worked. She was always at home, so we never had to go to the government kindergarten, the *sadochok,* which begins when a kid is three years old. Babushka taught us our ABCs, addition and subtraction, before we went to the first grade.

She told us the Bible stories she knew. Where there are no Bibles, the only way you can learn to know the Lord, to know what God is about, is to talk.

You spend time with your grandmother because you love her and listen to her and you learn what's true and what isn't. Then you go to school six days of the week, from nine in the morning to three in the afternoon, listening to the teacher and learning to become Young Pioneers, and then you join the League of Young Communists, the Komsomol.

So you become in-between. You just don't know what's right. For a certain period of your life, you go through a stage like being lost.

Finally, you really have to decide what you believe. You either become a person of your own—you learn things within your family and its beliefs, and you believe in them—or you are pulled into the society. Either you become a Christian, a believer in God, or you become the absolute opposite.

In the Soviet Union, everything is against God, against religion, against Christianity. Everything is for Communism. But Communism doesn't work. So this contradiction makes you think, question things. You press for answers and you have to guess for yourself what they are.

But we were lucky. We had our *babunia.* She taught us everything she knew about God, and about believing in Him and in knowing what was right.

—NATALIE POLOVCHAK WILCOXEN,
writing in *Freedom's Child,*
by Walter Polovchak (Random House, 1988),
a book which relates the story of young
Walter's defection from the Soviet Union.

Marxism Is Dead

The Communist Manifesto, published in 1848, is a clever piece of literature aimed at curing all the ills of society created by class antagonisms. With this taken into consideration, there is no denying the appeal of the communist "perfect society"—an end to exploitation, alienation, and human suffering. But Marx and Engels were wrong.

They asserted that "Society as a whole is more and more splitting into two great hostile camps, into two great classes facing each other—bourgeoisie and proletariat," and with an increase in class antagonisms there eventually would be a social revolution which would crush the bourgeoisie and create a "perfect society." Marx and Engels, however, turned out to be poor prophets. Instead of an increase in class antagonisms between the bourgeoisie and the proletariat, there has been a decrease. The reason for this is the capitalist revolution. Capitalism has provided a better standard of living and general well-being for the masses than Marx or Engels could ever foresee—and it shows no signs of decaying.

But is man better off? Has capitalism "left no other bond between man and man than naked self-interest, than callous 'cash payment,' " and "reduced the family relation to a mere money relation"? The capitalist society can be callous, and certain characteristics of the bourgeoisie often are contemptible, but with the proper institutions—especially family and religion—the vices of a free market society can be restrained and transcended, leaving more to life than "naked self-interest." *The Communist Manifesto* falls apart at this point and the authors' attempt to discredit religion and family turns out to be lame.

So who believes in Marxism? Is it an ideology for all nations as Marx and Engels claimed? History once again proves them wrong. There has yet to be a country which has experimented with Marxism and carried out its agenda word for word. Lenin ran into the problems inherent in strict Marxism and experimented with a limited market system—the New Economic Policy. China has been moving away from strict Marxism, as have several nations in the Soviet Bloc. It is evident that Marxism is fatally flawed, and except for a few godless radicals who naively hold to this ideology, it is dead.

—ROBERT JORDAN
Florida State University

Soviet Awakening

It is time to stop deceiving ourselves, stop believing the office ignoramuses and calmly admit that the problem of "consumer selection," the problem of competition, is not rooted in any social or class relationships. . . .

Bottom-line, market stimuli must extend to all stages of the process "research-development - investment-production - marketing-service." Only the marketplace, and not mere administrative innovations, can subordinate this entire chain to the demands of the consumer.

—NIKOLAY SHMELYOV
writing in the June 1987 issue
of the Soviet journal, *Novy Mir,*
as reported in the Montreal *Gazette*
(July 6, 1987)

Felix Morley Prize Winners

We are pleased to note that five young *Freeman* authors have been honored in the 1988 Felix Morley Memorial writing competition sponsored by the Institute for Humane Studies. Our congratulations go to Christopher L. Culp, Nick Elliott, John Hood, Philip S. Smith, and Robert S. Taylor. It has been especially gratifying for us to work with such promising young writers.

—BETH A. HOFFMAN & BRIAN SUMMERS

THE FREEMAN
IDEAS ON LIBERTY

Ebenezer Scrooge and the Free Society

by Howard Baetjer Jr.

Behaving in a self-interested manner does not mean disregarding others. On the contrary, because we are social beings who depend on, and often care deeply about many others around us, a sound attention to our self-interest must include a great deal of concern for others.

However true we may see this to be on a moment's reflection, many of us often lose sight of it, especially in our political and economic thinking. Particularly in regard to the free economy, a vague equating of selfishness and capitalism often infects people's thinking. The very word capitalism brings to many minds grim visions of ruthless characters damning the public interest or selling their mothers for farthings.

The archetype of the antisocial capitalist is Ebenezer Scrooge of Charles Dickens' classic tale, "A Christmas Carol." In Dickens' words, "Oh! But he was a tight-fisted hand at the grindstone, Scrooge! a squeezing, wrenching, grasping, scraping, clutching, covetous old sinner! Hard and sharp as flint, from which no steel had ever struck out generous fire; secret, and self-contained, and solitary as an oyster."

As many who attack the market would have it, Scrooge embodies the spiritual ruin of capitalism; he is the type toward which all capitalists tend. Indeed, I have a dear friend who jibes at my free market sympathies by quoting Scrooge's attitude about Christmas donations for the poor: "Are there no prisons? Are there no workhouses?"

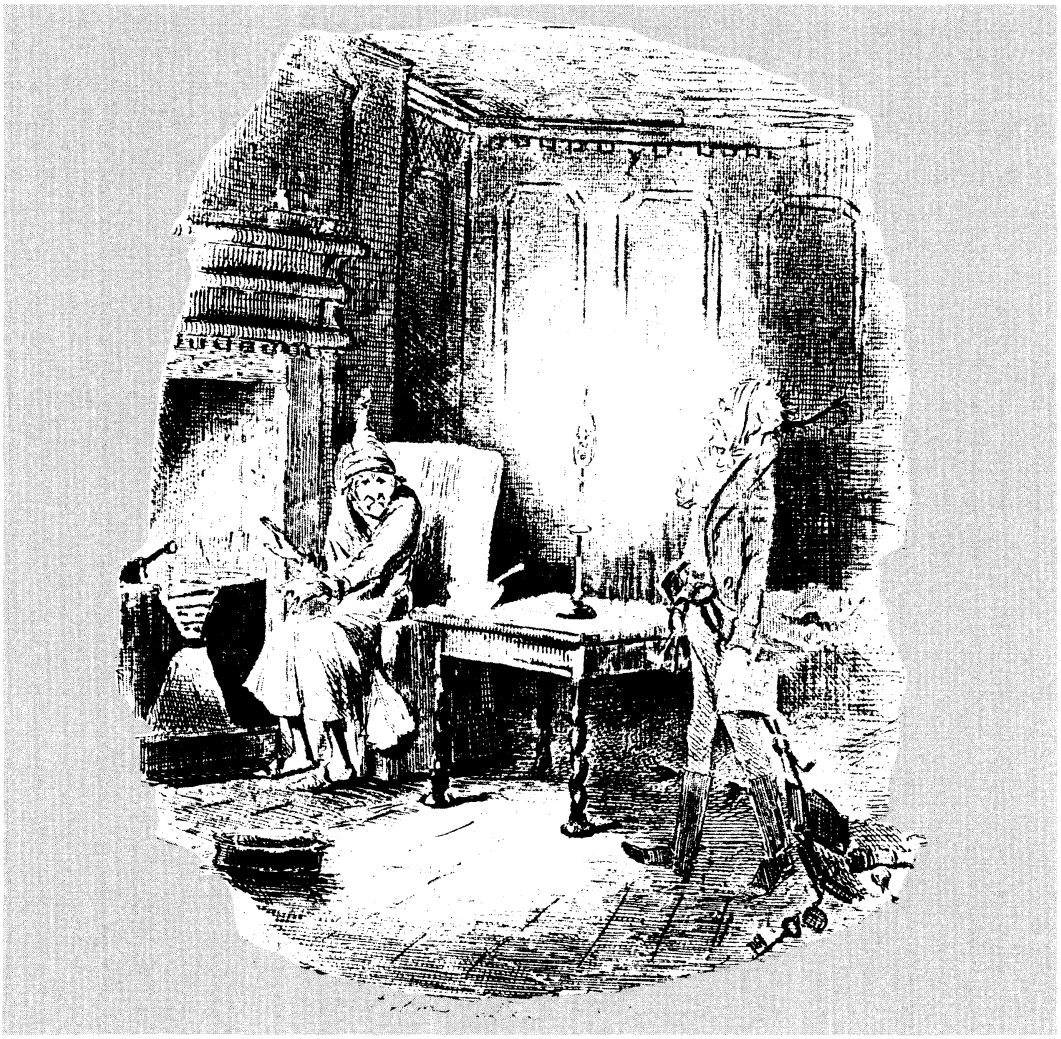
It is as if he believes that supporting the free market means forswearing kindness, as if simply entering the competitive whirl of business contaminates individuals with an attitude of competitiveness—or rather of strife—that poisons their relationships, distorts their perspective, and destroys their feeling for the brotherhood of man.

The widespread notion that free markets are corrupting is rooted at least in part in the innocent truism that for the market to work people must act according to self-interest. Without the motivation of self-interest, there would be no profit seeking, no price competition, no production and exchange. True enough, the market requires self-interested behavior.

But many make an illogical leap from this truism to a falsehood: that if one is self-interested, one cannot be other-interested. Many see an either/or choice. Scrooge can care about Scrooge, or he can care about others: the poor, his clerk Bob Cratchit, Cratchit's family, including lame Tiny Tim, and so on. He cannot do both.

Supporters of economic liberty will win to their cause very few people who believe in this notion. As long as they see self-interest to be at odds with cherished values of generosity and fellow-feeling, people will not embrace a polit-

Mr. Baetjer, a former member of the FEE staff, is a doctoral student at George Mason University, Fairfax, Virginia. This essay originally appeared as a chapter in Ideas on Liberty: Essays in Honor of Paul L. Poirot, *published by FEE.*



ical economy based on self-interest. Thus a task for lovers of liberty is to point out that self-interest and interest in others are not at odds, that in fact they go together.

They do. In fact, that is one of the main lessons "A Christmas Carol" teaches. The point of the story is that Ebenezer Scrooge, the archetypal "greedy capitalist," becomes immeasurably happier when and because he gives up his selfishness and becomes generously involved with those around him. There is no suggestion that he gives up his capitalism; in fact, Dickens tells us that he is at his desk early the day after Christmas. He just broadens his other activities and ends.

A quick recapitulation for those who may have forgotten the story: After refusing his nephew's invitation to Christmas dinner, refusing to donate anything to a Christmas fund for the poor, driving away a boy singing Christmas carols, and only grudgingly granting Bob Cratchit Christmas Day off, Scrooge goes home to a harrowing night. He is visited by the ghost of his old partner, and then in succession the ghosts of Christmas Past, Christmas Present, and Christmas Yet To Come. The ghosts open his eyes to the joy of his past Christmases, the opportunities he is missing in this one, and the unhappy end he faces if he keeps on his present isolated course. The next day, joyous that he can change the future by changing his behavior, he sends a prize turkey to the Cratchits, promises a large gift to the fund for the poor, goes to dinner at his nephew's, and generally enjoys himself hugely. Afterward, "it was always said of him,

that he knew how to keep Christmas well, if any man alive possessed the knowledge."

Scrooge's Mistake

This lovely tale emphasizes a point about economic man that is of overriding importance to the spiritual case for liberty. That is, maximizing money income is quite a different thing from maximizing well-being. For all his profit motive, Scrooge before the ghosts' visits is not acting to "maximize his utility," in the economists' term. In his mania for money, he is a cold, loveless, bitter man. In economic terms again, the opportunity cost of his ceaseless accumulation of assets is the far greater wealth in "psychic income"—pleasure—that he forgoes. No doubt Scrooge is doing what he perceives to be in his self-interest—each of us is *homo economicus* to that extent—but as the ghosts show Scrooge, he is making catastrophic mistakes.

As he hears his nephew say, at Christmas dinner in the dream, "the consequence of his taking a dislike to us, and not making merry with us, is, I think, that he loses some pleasant moments, which could do him no harm. I am sure he loses pleasanter companions than he can find in his own thoughts, either in his mouldy old office, or his dusty chambers." Scrooge loses music, laughter, blind-man's buff and other games. He loses all sorts of things that, as he observes them by the Spirit's side, have tremendous appeal. His maniacal attention to money simply cannot be called self-interested.

The next day Scrooge leaves his ledgers behind for once and goes unexpectedly to his nephew's house. Christmas dinner transpires as he had seen it in the dream, except that now he participates: "Wonderful party, wonderful games, wonderful unanimity, wonderful happiness!" He has progressed from unhappiness to happiness in an evening, thanks to a change in focus from narrow money concerns alone to a broader concern that includes the rewards of positive human relationships.

A related point is that among the greatest psychic satisfactions available to human beings are those that come simply from doing something for others we care about. I would not be misunderstood here: I am not talking about any benefit to those we care for, but just about the benefit to ourselves—the happy satisfaction, the warm glow, the serene contentment for us—that comes as a result of benefiting others.

It is rather like a pure market exchange: there is benefit on both sides. Scrooge, newly concerned for the bravely struggling Cratchit family, gives them a prize turkey. They benefit thereby; indeed, they are probably transported with delight. But they don't benefit any more than Scrooge. For him the cost of the gift is only the price of the turkey, while the benefit to him, the psychic return in joy, is, well, let us get it exactly: " 'I'll send it to Bob Cratchit's,' whispered Scrooge, rubbing his hands, and splitting with a laugh. . . . The chuckle with which he paid for the turkey, and the chuckle with which he paid for the cab, and the chuckle with which he recompensed the boy, were only to be exceeded by the chuckle with which he sat down breathless in his chair again, and chuckled till he cried."

Because others are important to us, it is in our own self-interest to give some attention to their well-being and, putting it impersonally, to invest in our relationships with them. These considerations apply beyond family and close acquaintances to the communities of which we are a part. Because we do live in our communities, community morale and standard of living have a bearing on our own quality of life. Hence it is self-interested to pay attention to the community and do what we reasonably can to improve it.

The Ghost of Christmas Present faces Scrooge with this in the persons of two children that cling to his robes:

> They were a boy and a girl. Yellow, meagre, ragged, scowling, wolfish; but prostrate, too, in their humility. . . . "They are man's," said the Spirit, looking down upon them. "And they cling to me, appealing from their fathers. This boy is Ignorance. This girl is Want. Beware of them both, and all of their degree. . . ." "Have they no refuge or resource?" cried Scrooge. "Are there no prisons!" said the Spirit. . . . "Are there no workhouses?"

Here we must be careful to grant the validity of

Dickens' point without guessing at his policy prescriptions. Experience with the Poor Law in his time, as well as many years of experience with the modern welfare state, show how very difficult it is to help poor people. Often the effort to do so, especially in a bureaucratic structure that operates by rule rather than by judgment about individual needs, creates disincentives to self-help, and thereby perpetuates poverty. The workhouses which Dickens hates were a government effort to care for the poor. The best we can do for such unhappy souls may well be not to give them much, but rather to work for the repeal of bad laws which obstruct their advancement. In any case, the point remains that since our lives and fortunes are tied up with theirs, it is in our self-interest to do what we may to improve their quality of life. Charity can be at once generous and self-interested.

The Importance of Spiritual Goods

Another lesson of "A Christmas Carol" that can fortify the spiritual case for liberty is that material goods are often a prerequisite for spiritual goods. We tend sometimes to think that there is an either/or choice among these, too. Either we concern ouselves with "higher" matters of love, community, and doing well by others (good!), or we concern ourselves with the "low" business of producing and accumulating physical stuff (bad!).

But we are creatures of flesh and blood as well as of spirit, and we must be fed, clothed, and sheltered adequately if the spirit is to soar. We can do little for others or ourselves if we lack the means to do it with. And ultimately all money—indeed, all material goods—are means to spiritual or psychic ends. We don't want them for themselves, but for the satisfactions they can give. Scrooge discovers during the ghosts' visits that his piles of wealth are valueless to him if all he ever does is pile up more. Not until he uses his money does he "cash in" on the psychic satisfactions that are the point of the whole endeavor.

Consider the story's final episode, when Scrooge reveals his changed self to Cratchit. He says earnestly:

> "A merry Christmas, Bob! . . . A merrier Christmas, Bob, my good fellow, than I have given you for many a year! I'll raise your salary, and endeavor to assist your struggling family, and we will discuss your affairs this very afternoon, over a Christmas bowl of smoking bishop, Bob! Make up the fires, and buy another coal scuttle before you dot another i, Bob Cratchit!"

Good for generous Scrooge! His attention now encompasses the "higher matter" of his clerk's well-being. (By the way, observes the economist, Cratchit's productivity will probably increase substantially.) But how could Scrooge be generous without his cash? What would pay the higher salary, go to assist the family, buy the Christmas bowl and extra coal? Praise the Lord for Scrooge's money and his ability to earn it! May he continue to do so! It's cash that lets a generous impulse become a generous deed.

Now of course I don't mean to imply that in a free economy all will realize the extent to which their happiness increases by generous concern for others. Certainly in a free society some people will choose a low, selfish, small-spirited, narrow way of life. Surely they will be less happy because of this choice than they would otherwise be. And not all of them will have Scrooge's good luck in being brought back to his senses by the intervention of kindly Spirits of some kind. This is to be lamented.

But this unfortunate choice of a less happy rather than a more happy way of life is just that—a choice. It is not caused by the free society which allows it; it is caused by the individual's own short-sightedness, unwisdom, and inability to perceive that real self-interest depends substantially on other-regarding activities.

The good life involves a judicious balance of self- and other-regarding activities. When the balance is a healthy one, these two reinforce each other and merge. The wonderful thing about the free society is that it allows human beings such broad scope in which to pursue and fulfill all their values, whatever they may be—material, personal, spiritual—and puts in our way an abundance of resources and opportunities with which to pursue them all. □

The Liberating Arts

by Edmund A. Opitz

The recent movie called *Out of Africa* has acquainted millions of Americans with the name of a Danish Baroness Blixen, whose pen name was Isak Dinesen. The movie is based on Dinesen's 1938 book, a semi-autobiographical work called *Out of Africa*. Four years earlier, in 1934, Isak Dinesen had published a work entitled *Seven Gothic Tales*, really seven short novels within the covers of a single book. One of these Gothic tales was set in the Paris of several generations ago and consisted mainly of the reminiscences of an old gentleman. There is a story within this larger story involving an Armenian organ grinder and his pet monkey. Some of you may recall seeing this type of street musician who would wander through city neighborhoods carrying, slung over his shoulder, a kind of music box the size of an accordion, a crank on its side. This contraption was set atop a pole, which supported the weight of the music machine when the man stopped to perform. The man would be dressed in a sort of gypsy costume, and as the entertainer cranked out his tunes his little capuchin monkey would pass through the crowd collecting coins, which he'd turn over to his master. This in itself was quite a stunt; but this little monkey was cleverer than most of his kind, because his master had taught him to perform a great variety of crowd-pleasing tricks, each one triggered by a word of command—in Armenian.

The Reverend Mr. Opitz is a member of the staff of The Foundation for Economic Education and is the author of the book Religion and Capitalism: Allies, Not Enemies. "The Liberating Arts" *was presented as a FEE Seminar lecture in Alderbrook, Washington, earlier this year.*

The Armenian died, and the little animal came into the possession of a kindly French couple who housed the monkey and fed him well. Time passed, and although the animal was properly cared for, he languished; he seemed to know that he had talents lying dormant which no one knew how to bring out. There was no one to voice the magic Armenian words. Lots of potential talent was trapped inside the little beast, but no one knew how to release it; the key had been lost.

It is my guess that Isak Dinesen intended this little story to be a parable of the human condition. Translate the parable and it suggests that individual men and women are loaded with potential talents of all sorts—talents unlimited—but these potentialities are locked up inside us and become actual only when touched by a magic wand from without—the magic wand called "education."

The scholastic curriculum labeled "liberal arts education" emerged, developed, and grew—in the course of centuries—in order to give the young people of each successive generation the tools of learning, tools which they could then use to free themselves from the hindrances and obstructions, the ignorance and taboos which prevented them from becoming the kind of persons they had it in them to be. The "liberal arts," in other words, were the "liberating arts"; they freed the individual person from all that prevented him from realizing his full potential. The ultimate goal of liberal education is wisdom and understanding—a broader and deeper understanding of human nature and the human condition, and a few clues as to the pur-

poses of our earthly pilgrimage. Education deals with the goals of life; it is "ends oriented," and its primary tools are language, literature, philosophy, history, and mathematics.

Education and Training

Education is not the same as training. Training has to do with "how-to" knowledge, with practical instruction; training is what might be called "instrumental" knowledge. Training deals with means rather than with ends—ends being the province of education. The world could not continue on its course without the help it gets from the millions of trained men and women who accomplish the world's work—the scientists, inventors, entrepreneurs, engineers, and technologists; the doctors, dentists, nurses, manufacturers, managers, and so on. If asked to name an American exemplar of the trained man, most of us would mention someone like Thomas Alva Edison. Edison's kind of genius has given us inventions which have transformed life in modern societies in many beneficial ways; our life is cleaner, brighter, healthier, more convenient—and noisier—because people like Edison have lived and worked. We have many more things; sometimes it seems that gadgetry almost overwhelms us!

Virtually everyone acknowledges the important contributions of trained people; they keep our society going, and they make it better. They have enormously increased the number and potency of our means; enormous power is now at our disposal. But what about the people who are schooled merely in the liberating arts; what role might they aspire to play in our culture? If students have been exposed to the best that has been thought and said about man, the human species, so that they have some understanding of what it means to be a person, some understanding of the nature, destiny, and proper end of a human being, then—if such people are heeded by those with know-how and power—we might yet scrape together sufficient wisdom to save our society from being fragmented by the detonation of its newly released energies. It seems to be our fate to live at a time in history when enormous power is in our hands but barely under our control. Ideas still rule in human affairs and we won't know what to do with our recently acquired powers until we have decided what to do with our lives. And that is where the liberating arts come in, for it is a main function of a liberal education to help us face up to the question of how to make our lives count for the things that really matter.

Education and Schooling

I have briefly drawn a distinction between education and training and I shall now draw an equally important distinction between education and schooling. No society before our own has ever put so much faith in schooling, which we usually mislabel "education." Virtually no child in America lives beyond the reach of his local public school and every child's exposure to public schooling is compulsory. A few generations ago schooling at the college level was deemed a rare privilege; but now there are as many local community colleges as there once were high schools; the college population in this nation has exploded during the past generations while the curriculum has been downgraded. We proudly point to our vast network of schools and colleges as our "educational establishment," when it is no such thing. Education does occasionally occur in our schools and colleges, but it is rare to find a student who is really educable. In one of Will Durant's early books, written in 1929, he mentions a foreign student who came to this country to get a graduate degree at one of our great universities. Shortly before he returned to his native land the young student summed up his experience by declaring: "American universities are really athletic institutions, with opportunities for study for the feeble bodied."

My remark a moment ago that only the occasional college student is really educable may sound arrogant and elitist. But it wouldn't have sounded at all elitist if I had referred to the occasional educable student as a bookworm! It's a fact; liberal arts education is primarily for bookworms—a bookworm being defined as a kid who's mesmerized by the printed page. The liberal arts scholar frequents the library, not the laboratory; he gets his education by studying the books and papers written by other scholars.

And a liberal arts scholar is the kind of person who does quite well in the typical IQ test, the Stanford-Binet test, for example. I would point out to you that what is measured by the typical IQ test is not the only kind of intelligence human beings possess; but it *is* one kind. The results of an IQ test predict reasonably well how the individual would fare in a typical liberal arts curriculum. But that's it!

Many years ago when I was studying in Berkeley at the Pacific School of Religion our psychology teacher was the head of the psychology department at the Univerity of California. Of course he had to expose the theological students to an IQ test. As it turned out we did reasonably well, having an average IQ score of over 130 compared to the average of the graduate students at the University next door of about 120. Does that mean that we were smarter than the students at U Cal? Not at all. It simply means that we had a different knid of smartness than the graduate students in physics, or chemistry, or geology, or astronomy; our forte was book learning, their intelligence was of another species. The modern world has suffered unduly from its failure to understand important distinctions in this area of schooling. We exhibit a weak understanding of the role of the liberal arts program—it's not for everyone—and we extravagantly over-value the figures obtained by IQ testing.

We began about a hundred and fifty years ago to set up a vast system of compulsory public instruction in this country. With the centuries-old liberal arts tradition in mind we geared our school system into the three R's—Readin', 'Ritin', 'n' 'Rithmetic. This was a system well adapted to bookworms; it prepared them to enter one of our liberal arts colleges. But it was not adapted to the youngsters whose intelligence ran in the direction of vocational and technical training. School, for them, tended to be a frustrating experience.

Come down to the period after World War II when someone decided that everyone ought to have a college education. There was a vast expansion of the student population. Teachers in great numbers were needed and hired, but only a few men and women in each generation have a true vocation to teach, and only a few students have a vocation for a liberal arts education. There was bound to be trouble. Trouble came, and it turned many campuses into what resembled battlefields. Our first mistake was to set up a system of compulsory public instruction, and then we compounded this error by refusing to recognize the important distinction between education and training.

Needed: Talents

A complex modern society needs a great diversity of talents, and not all talented people, by any means, are good material for a liberal arts education. As a matter of fact, no society can absorb more than a tiny percentage of people with a liberal arts Ph.D.—too many liberal arts doctors will ruin any society! But no society can have too many honest craftsmen and artisans . . . butchers, bakers, candlestick makers, and all the rest. The head is important; the hands are important. More important is the proper balance between them. Listen to John Gardner on this point: "The society that scorns excellence in plumbing because plumbing is a humble activity, and tolerates shoddiness in philosophy because philosophy is an exalted activity, will have neither good plumbing nor good philosophy. Neither its pipes nor its theories will hold water."

This lack of balance was perceived by an astute French critic, Ernest Renan, more than a century ago, but we did not heed his warning: ". . . .countries which, like the United States, have set up considerable popular instruction without any serious higher education, will long have to expiate their error by their intellectual mediocrity, the vulgarity of their manners, their superficial spirit, their failure in general intelligence."

Every one of us has encountered persons of enormous energy and enthusiasm; bursting with ideas which sound plausible but whose projects fizzle out without getting anywhere. I once knew such a man. He had written a widely noticed book during the thirties, and since that time had started numerous organizations to save the world. The world persistently refused the offer. Discussing the matter with a friend some years ago I wondered aloud why so-and-so had never gotten himself off the ground. "The trouble with him," said my friend, "is

Harvard Hall (left center; built 1776), Harvard University, Cambridge, Mass., c. 1849.

that he got his drive shaft installed before his steering wheel."

It is a prime function of a liberal education to provide us with the moral equivalent of a steering wheel, and perhaps a map, as well. A bishop of the early church said much the same thing when he declared that society needs three kinds of men: those who work, those who fight, and those who pray. Society needs someone to grow the wheat and bake the bread. It needs someone to stand guard and protect the producer against marauders. But in addition, every society needs those who continually remind the rest of us that there is more to life than taking care of our creaturely needs. Man has a spiritual and intellectual nature with needs just as real as our physical hungers. Human life has meanings which transcend material comfort or even physical survival, and we will not resolve our material and social problems until we absorb those meanings and live by them.

Scholarship, therefore, has a significance beyond mere scholarship. The tradition of Western learning goes back to Socrates—or to Plato. These men laid down the lines along which most serious thought has moved until our own time. This body of thought, which goes back nearly two and a half millennia, comprises "the grand old fortifying classical curriculum" of our ancestors. It is like the Gulf Stream, coursing through the Atlantic as it comes down to us through the generations, touching, at any given time, only a handful of persons. There is only a little exaggeration in Emerson's observation that "There are not in the world at any one time more than a dozen persons who read and understand Plato—never enough to pay for an edition of his works; yet to every generation these [works] come duly down for the sake of these few persons. . . ."

The custodian of this intellectual treasure of ancient learning is the university. Every college in the American colonies consciously partook of this heritage, and likewise most of the colleges founded during the nineteenth century. The first of our colleges, Harvard, was founded in 1636. John Harvard, an eminent English divine, came to the new world in 1637 and was immediately involved in supporting the college. He donated half his estate, nearly 800

pounds, plus his 320-book library, and a grateful citizenry named the college after him. William Bradford, of *Plymouth Plantation* fame, traces Harvard's line of descent: "A light was kindled in Newtown [that is, Cambridge] in the Bay Colony in 1636. But the spark that touched it off came from a lamp of learning first lighted by the ancient Greeks, tended by the Church through the Dark Ages, blown white and high in the medieval universities, and handed down to us in direct line through Paris, Oxford and Cambridge." Harvard College was largely a duplicate of Emmanuel College, the most Puritan of the Cambridge (England) colleges, and the one where John Harvard earned his Master of Arts degree. The Harvard curriculum was the classical liberal arts educational scheme unique to Western Civilization.

Western Civilization

A hundred and thirty years ago, Cardinal Newman paid an eloquent tribute to Western Civilization, the historic culture within which most of us were reared. Its nature is such, he argues, that, to all intents and purposes, Western Civilization and Civilization are equivalent terms. This idea is under deadly attack these days, so let me allow Cardinal Newman to say what he has in mind, in his own words: ". . . though there are other civilizations in the world, as there are other societies, yet this civilization, together with the society which is its creation and its home, is so distinctive and luminous in its character, so imperial in its extent, so imposing in its duration, and so utterly without rival upon the face of the earth, that the association may fitly assume to itself the title of 'human society,' and its civilization the abstract term 'civilization.' "

These words of Cardinal Newman are taken from a lecture he gave in Dublin in 1858. England was at the height of her powers, prestige, and self-confidence. Britannia ruled the waves; her colonies were on every continent, leading to the proud declaration that the sun never sets on the British flag. The English gentleman was regarded the world over as the model, as the human male *par excellence*. English was a universal language. "Never since the heroic days of Greece has the world had such a sweet, just, boyish master," declared the noted philosopher, George Santayana.

Much has happened since Newman's day to change that picture. We now know that high levels of civilization were attained in Asia and Africa thousands of years ago, long before Greece and Rome emerged onto the world scene. Civilization can no longer be regarded as simply a European thing. But note that it was through the work of European scholars during the past couple of centuries that the world came to know something of the glories of ancient China, India, and Egypt. The people of India had lost contact with their remote past, and owe it to the work of English scholars that ancient Hindu literature—such as the *Vedas* and the *Upanishads*—was discovered, translated from the Sanskrit, and read for the first time—in English—by Hindu students!

The growing awareness of ancient civilizations upset the idea that the culture whose time span stretched from Homer to the Victorian Age was the world's only civilization, and this new knowledge also caused Europeans to have a keener perception of the defects of their Western world. Besides, the English were weary of bearing the white man's burden, and, in the colonies, the natives were restless. Herbert Spencer, writing a letter to Grant Allen just before the turn of the century, voiced the opinion that ". . . we are in course of re-barbarization."

But it was World War I that really stunned the West and proved to the rest of mankind that Western world hegemony was but a shadow and no longer a thing of substance. The statesmen of Western nations played their dangerous games during the early years of this century, completely lacking in the kind of foresight which wiser statesmen might have employed to anticipate the horrible end results of the trends they had set in motion. A Serbian terrorist assassinated an Archduke and the whole house of cards began to crumble. A man named Francis Neilson resigned from Parliament in 1914 to publish his book, *How Diplomats Make War,* a piece of foresight that reads like hindsight. But not even Neilson could anticipate that the war would continue its slaughter for four dreadful years. Virtually no one in August of 1914 believed that the war

would involve millions of combatants from nations all over the globe. Some did, of course. Viscount Grey of Fallodon, the English Foreign Secretary until 1916, uttered the gloomy prophecy, "The lights are going out all over Europe, and we shall not see them come on again in our lifetime." The opinion of the man in the street I heard from the lips of Max Brauer, the mayor of Hamburg in 1938, who lectured that year in Berkeley: "We all thought we'd be home for Christmas," that is, in four months.

A youngish German high school teacher spent the last year or so of the war writing a book. Volume I appeared in 1918; volume II in 1922. New York publisher Alfred Knopf brought out an English translation in 1926, entitled *The Decline of the West*. It was not easy reading and the thesis was dubious. But the pessimism of Oswald Spengler matched the post-war despair and gloom of many people in Europe and America, with the result that *The Decline of the West* was probably the most talked-about book and the most written-about book of the 1920s and '30s. Spengler's overwrought book seemed to say in exhausting detail what many felt in their bones—that Western Civilization was finished, *kaput*. Spengler despised the Nazis and had no use for Communism, but his devaluation of the West added fuel to Soviet expansionism by making it appear that some kind of Marxism was the only viable alternative now that the West was sinking below the horizon.

Our Present Situation

Where do we stand today? I think we must admit that Cardinal Newman's panegyric to Western Civilization was overstated; there were and are, we now know, other civilizations which merit our respect. That's the first point; and the second is to emphasize that although Western Civilization is not the only civilization, it is *our* civilization; and only persons firmly rooted in their native habitat can come to a proper appreciation of, say, Hindu culture, or Chinese culture. Those who are alienated from their native soil fall prey to charlatans. We have recently witnessed the spectacle of a grubby turbaned clown, who'd be ridiculed by real Hindu scholars, conning gullible Americans into parting with their money and with whatever wits they possessed in order to grovel at his feet. Genuine Hinduism serves the spiritual needs of millions of Indians, but fake Hinduism is a bad joke; and so, of course, is fake Christianity as other recent events remind us.

In any event—to return to our original theme—the liberal arts curriculum has been *the* educational scheme of Western Civilization, and will be again. A civilization like ours has immense and still untapped powers of recovery and regeneration—as its story is told in several of the books in my bibliography. It has been said that no civilization has ever been murdered, never destroyed from without. Civilizations suffer decay from within, and crumble; that is to say, they commit suicide. But a civilization which responds vigorously to challenges from within and challenges from without may renew itself. It all depends on the kind of people who compose that civilization. In other words, the fate of our society depends on us, and we can work on ourselves.

Reviving the Freedom Philosophy

It was a set of ideas along these lines that inspired Leonard Read to set up The Foundation for Economic Education 42 years ago. The American nation had lapsed into a New Deal type of socialism because this country's citizens, for several generations, had failed to educate themselves in the freedom philosophy. The beliefs upon which our eighteenth-century ancestors had erected the basic political and economic structures of this society no longer inspired us even to maintain those structures. And during the decades when the freedom philosophy was in remission, the ideologues of socialism carried on an unremitting campaign to persuade people that the government could run things better than we could run them ourselves. The socialists manufactured a new public opinion different from the original and, as a result of the inculcation of bad ideas, we are saddled with numerous bureaucratic interventions into every sector of our lives.

The suggested FEE remedy is two-fold: first, try to arouse an interest in personal liberty and the free society; and second, nourish this new

interest in freedom by having on hand books, pamphlets, periodicals, and speeches expounding the freedom philosophy. Thus, gradually, bad ideas will be replaced by better ideas. Right action will follow. The Foundation emphasis is on self-education. And when you come right down to it, self-education is the only kind of education there is. A wise and experienced teacher is one who has been over the route before, so he can tell you where the minefields are, which roads are blind alleys and which are dead ends, and which books are worth studying. But there's one thing no teacher can do: he cannot educate you. You have to educate yourself. "Educate" is not a transitive verb, that is, education is not something that anyone can do to another or for another. But anyone who has the incentive can do it for himself.

I first encountered this approach years ago in a pamphlet by the eminent British novelist, Arnold Bennett; it was entitled "How to Live on Twenty Four Hours a Day." You can make your own life more exciting and fulfilling, wrote Bennett in the breezy manner of a novelist, if you resolve to learn some subject, any topic of your own choosing—like political economy—and make a pact with yourself to spend 90 minutes three evenings a week in intense study. This does not mean merely sitting down with a book in front of you, which is all you'll be able to do at first. You'll start to read, and after a few pages your mind will be miles away. Grab your mind and drag it back by the scruff of the neck! says Bennett, and gradually your mind will realize that you are in charge and that you mean business. At this point your mind will start to pay attention and do what you demand of it.

Another way to teach your mind that you are in charge of it is to spend a few minutes before retiring rehearsing the events of the day, hour by hour: what you saw, heard and did, whom you met, what you said, and so on. Once your mind realizes that it will be called upon to recite at the day's end, it will begin to pay attention during the day; you'll experience things more vividly and thus recall them more readily. Plan to keep a daily journal, as Leonard Read did for years.

The liberating arts require a lot of reading, and reading requires seeing, which is why I recommend *The Art of Seeing* by Aldous Huxley. Reading does not come naturally; reading is an acquired skill, like playing the fiddle or walking on your hands.

You can teach yourself to read better with books like Walter B. Pitkin's *The Art of Rapid Reading*. Several courses are now available which teach speed reading, but I don't know how well they live up to their claims. I do know it to be a fact that anyone can train himself to read easier, faster, and with greater pleasure. Better comprehension follows. Use a red pencil to bracket and underline salient points. This is an aid to memory and helpful for later review.

The Art of Thinking

Now that you have awakened a few billion brain cells and pumped some information into them, your mind will begin to churn out ideas and you'll be thinking lots of new and exciting thoughts. What is it like to think? Let me quote a few lines from Jacques Barzun, a first-rate thinker: "Thinking is inwardly a haphazard, fitful, incoherent activity. If you could peer in and see thinking going on, it would not look like that trimmed and barbered result, A Thought. Thinking is messy, repetitious, silly, obtuse, subject to explosions that shatter the crucible and leave darkness behind. Then comes another flash, a new path is seen, trod, lost, broken off, and blazed anew. It leaves the thinker dizzy as well as doubtful; he does not know what he thinks until he has thought it, or better, until he has written and riddled it with a persistence akin to obsession."

Once you get hooked on thinking you'll be irresistibly drawn into writing, and you'll quickly discover that almost no author who relies on the contents of his own mind alone ever wrote a readable essay, let alone a book. Every thinker and writer needs to know how to use reference books and conduct research, and the complete guide to this is the book, *The Modern Researcher,* by Jacques Barzun and Henry Graff. But you cannot stop there; you have to learn to write passable English prose, and there's no easy way to do that. The most helpful book on writing, in my view, is

Barzun's *Simple and Direct*. If you're interested in knowing how the ancient Greeks went about the chore of putting together a persuasive speech, look into Aristotle's *Rhetoric*.

The human person is emphatically *not* the mere accidental end result of the chance interaction of physical and chemical forces, however much it might please certain of our contemporaries to believe this. Nor is man some untidy excrescence appearing on the earth's surface sometime between the last two ice ages, tossed about by the same natural forces which rust iron and ripen corn. To the contrary, every man and woman is a work of divine art; through our being flow the primordial creative forces of the universe. Coordinate with those forces and we become creators too, some of us in small and others in large measure.

Novelty comes onto the cosmic scene with every thought we think. The future is still in the making, and there's no action we take that does not alter the future in some degree. The future really *is* in our hands, and this is a responsibility we cannot avoid. Even if we do *nothing*, the future inexorably records our inaction, by being a little bit different than it would have been, had we done *something*.

The center of human creativity is the individual human mind, and the creative process in thought, literature, music, and art is the subject of *The Creative Process*, a wide-ranging anthology edited by Brewster Ghiselin.

To sum up: I've had some things to say about the ages-old liberal arts curriculum as an essential element of Western Civilization. Now that we know something of other great world civilizations we realize that we can learn from them, but only if we retain a firm hold on our own heritage. I have pointed out that education is not at all the same thing as schooling, and I have argued that education and training are not quite the same. All genuine education is self-education. But you must first train yourself, in order to acquire the tools of learning you need to educate yourself with. Education deals with ideas, and ideas rule the human world. The man or woman who thinks is an influence on those who come into contact with him, and by his thoughtful actions he exerts leverage over the future.

Albert Jay Nock was a product of "the grand, old, fortifying classical curriculum," and it's fairly safe to refer to Nock as the most exquisitely educated gentleman of the first third of this century. And Nock thought of himself as a superfluous man! It is certainly true that a classical education will not make you the life of the party; it won't put you among the rich and famous; it might even make you feel superfluous. But "the fun is in the going"; where it gets you is secondary. Self-education is a never-ending series of challenges. Each challenge we surmount only confronts us with a bigger and more complex challenge—and a wider horizon. But that's what life is all about. And such a life is never dull! □

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The Decline of Secondhand Bookstores

by Herbert London

Jacques Maritain once said that what distinguished New York from the other great cities of the world is that it is in constant flux. New York does not treasure its past as is the case in Paris; it treasures the future. There is much in the recent history of this city that supports that claim.

Nevertheless, there are New Yorkers who continually lament the loss of the past. One of the most vocal groups is comprised of bookstore owners and shoppers on Bookstore Row (the area on Fourth Avenue between Ninth and Fourteenth Streets). According to these people the used bookstore is gone forever, a casualty of bottom-line economics. The culprit in this scenario is rising rentals and, as one might guess, the proffered solutions are government subsidies, the use of government-owned space, and commercial rent control.

However, the analysis of the problem as well as the much-discussed answers leave much to be desired. The actual decline in used bookstores did indeed occur for economic reasons. But these reasons are related to the value or lack thereof in used books far more than to the obvious rises in rent. The fact is paperback books and discounted hardbacks have virtually eliminated a general interest in used books. It's hard to be in the business of selling a commodity that has limited or nonexistent value.

Yet antiquarian bookselling manages to survive and in some places thrive. The Gotham Book Mart, the Strand Book Store, the Pageant Book and Print Shop and the Academy Book Store are examples of stores that are prospering. Fred Bass, the owner of the Strand Book Store, the nation's largest used bookstore, said, "My rent tripled . . . but I think it's a healthy business." The reason why these stores prosper is that they provide a service to their clients that cannot be offered in the bookstore chain outlets.

As is often the case when economic conditions change, businessmen adapt. Many of those stores that were fixtures on Fourth Avenue have been converted into off-street mail-order and catalogue sales outfits serving an established clientele. Several of the used book dealers have convertible fold-away street stands that can be taken to the parks or a book fair. Surely the glory days of row after row of used bookstores below Union Square is gone or going. But it would be an error to conclude that used bookselling is on its way to extinction.

Efforts to stop or curtail economic trends—in this case through rent subsidy or rent control—are doomed to failure, as are virtually all efforts to impose the will of a command economy on markets. The tale of used bookstores in New York is, in a sense, the story of this city. What is fashionable changes. What is affordable changes as well. The low rent district of today may be the high rent district of tomorrow. Were it not this way, New York would be a static town.

Interest groups like bookstore owners, community boards, and the rent control lobby would like to see a city in which their concerns are protected through government intervention. To an extraordinary degree these groups have flexed their political muscle and found responsive city politicians. But that is no way to run a city, especially a city as dynamic as New York City. Markets may not be the perfect adjudicator of competing interests, but they are far more efficient over the long term than the "visible foot" of government interference. The disappearance of Bookstore Row and the survival of used bookstores would seem to prove this point. □

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Origins of the German "Economic Miracle"

by Robert A. Peterson

This year marks the 40th anniversary of Ludwig Erhard's sweeping free market reforms which gave economic freedom to over 80 million Germans and began West Germany's 30-year post-war economic miracle.

At the end of World War II, Germany was in a shambles. Fire bombs—more destructive than the atomic bombs that were dropped on Hiroshima and Nagasaki—had completely destroyed Dresden. The population of Cologne had dropped from 750,000 before the war to less than 32,000. Germany's storybook castles and great cathedrals lay in ruins, while makeshift shanty towns housed hundreds of thousands of Germans displaced by the Soviet occupation of the Eastern Provinces.

Industrial output was at a standstill, and German currency was practically worthless. A pack of American-made cigarettes could fetch more goods on the black market than hundreds of German marks.

William H. Peterson, who was a member of the Allied occupation forces, described the scene this way: "German men and women, for the most part ragged, hollow-eyed, thin, forlorn-looking, peddled what wealth had escaped the bombing and burning—silver, jewelry, Zeiss binoculars, Leica cameras, Meissen china (frequently chipped) and bric-a-brac including ashtrays, lamps, clocks, and cheap paintings—all at fancy prices. I saw a used commonplace alarm clock go for the equivalent of $85—in 1945 dollars."[1]

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There was little hope for improvement. Incredibly, the Allies—who had freed Germany from the Nazi terror—imposed their own form of economic tyranny by maintaining Hitler's price and wage controls.

Enter Ludwig Erhard. Born in 1897 in Furth, and educated at the University of Frankfurt, Erhard had been a disciple of the great free market economist, Wilhelm Roepke. After serving as an economist in Nuremberg, Erhard was appointed head of the post-war Bizonal Economic Council. Looking over the wreckage from six years of total war, Erhard knew that only free market policies could get Germany back on its feet. To that end, he made two proposals: introduce a new currency, then insure its success by lifting wage and price controls.

None of the experts doubted the necessity of his first proposal, but lifting wage and price controls? That went against current orthodoxy. When General Clay, military governor of the American Zone, informed Erhard that all the American economic experts were gravely concerned about the consequences of scrapping the wage and price controls, Erhard replied, "So are mine."[2]

Yet Erhard plowed ahead. He knew his history: more than 2,000 years of price and wage controls had always resulted in economic chaos. Not only do price and wage controls destroy incentives, Erhard pointed out, but they almost always transfer wealth from hard-working, patriotic citizens into the hands of cynics, bureaucrats, and those favored by the government.

Taking the country by surprise, Erhard went on the air on a Sunday night in June 1948.

First, he announced that each German would be given forty Deutschmarks (replacing the old Reichsmarks). This would be followed by a second installment of twenty Deutschmarks. Credits and debts would be converted into the new currency at the rate of ten to one, and people would have to prove how they came by sums that exceeded 5,000 Reichsmarks.

Erhard knew that his current reform would be doomed if the new money, like its predecessor, faced bare store shelves and empty warehouses. To prevent this, Erhard announced the second—and by far more important—part of his program: most of Germany's wage and price controls would be dropped. First, controls would end on a wide range of consumer goods. Within six months, controls on food would be dropped. Erhard gained support for his measures by billing them as a patriotic move designed to replace a "foreign" economic system that had been imposed on Germany. The German people were astonished to hear that all these changes would commence the next morning.[3]

Almost immediately, the German economy sprang to life. The unemployed went back to work, food reappeared on store shelves, and the legendary productivity of the German people was unleashed. Within two years, industrial output tripled. By the early 1960s, Germany was the third greatest economic power in the world. And all of this occurred while West Germany was assimilating hundreds of thousands of East German refugees.

The Marshall Plan certainly helped, but its influence was not great enough to cause the German "miracle." As historian LaVerne Ripley points out, "vastly larger sums have been donated to other countries without preventing their economic disaster."[4]

Since the 1960s, Germany has turned away from Erhard's free market policies. Many German young people missed the significance of Erhard's reforms, while as *U.S. News & World Report* recently observed, "Chancellor Helmut Kohl has been a timid free-marketer."[5] After achieving wealth and leisure time by pursuing free market policies, a new generation of social engineers has devised schemes to divide the wealth, disregarding how that wealth was created. Intellectuals provided moral support for the move toward socialism, even though the very leisure they used as an excuse to undermine capitalism was itself the result of capitalism. The process is still going on.

The move toward socialism has manifested itself in higher taxes (West Germany has the highest corporate taxes of any Big Five economic power), unreasonable demands from labor unions, a 37.5-hour work week, and over-regulation. The result is that West Germany is, as one commentator put it, "Rusting on the Rhine."[6]

German legend has it that the great medieval ruler, Frederick Barbarossa (Red-Beard), is asleep inside Kyffhauser Mountain in Thuringia, awaiting the day when Germany is about to be destroyed by its enemies. Just at the last moment, so the legend goes, Barbarossa will be awakened by ravens encircling his mountain top. He will then arise and wrench his homeland from defeat and bear her to the glory of a new golden age. (There was method in Hitler's madness when he code-named his invasion of Russia "Operation Barbarossa.")

Ludwig Erhard didn't sport a red beard, nor is there any evidence that he spent much time near Kyffhauser Mountain. But he did save Germany, for a time, from one of its greatest enemies—socialism—and helped bring about one of the great success stories of the modern world. Today, West Germany, as well as the rest of the world, would do well to learn from Ludwig Erhard's example, on this, the 40th anniversary of his reforms. □

1. William H. Peterson, "Inflation: Soviet Style, 1945," *The Freeman*, April 1985, p. 208.
2. William Henry Chamberlin, "The Failing Dynamo," *The Freeman*, May 1969, p. 293.
3. "Forty Years old, Deutschmark is Still Going Strong," *Der Deutsch-Amerikaner*, June 1988; Robert-Herman Tenbrock, *A History of Germany* (Munchen: Max Heuber Verlag, 1968), p. 315.
4. LaVerne Ripley, *Of German Ways* (New York: Barnes and Noble Books, 1970, 1980), p. 227.
5. Pamela Sherrid, "Rusting on the Rhine," *U.S. News & World Report*, April 11, 1988, p. 36.
6. *Ibid.*

Profits from Power: The Soviet Economy as a Mercantilist State

by Gary M. Anderson

Austrian economics has achieved at least one clear and unambiguous victory in the battle of ideas in this century—the Austrian critique of the possibility of socialist calculation handily won the debate in the 1930s and 1940s (see Karen Vaughn's 1980 article for a recent assessment of this intellectual triumph). Mises' classic 1920 statement, later supplemented and expanded by F. A. Hayek (1948), Lionel Robbins (1934), and Ludwig von Mises himself (1949, and elsewhere), argued that rational economic calculation under socialism is impossible. Rational allocation of scarce resources requires market exchange in the context of money prices; socialist planners cannot hope to replace the price system with a central planning organization while retaining coordination in the complex structure of production of a modern economy. Mises stated his critique unequivocally:

> Without calculation, economic activity is impossible. Since under Socialism economic calculation is impossible, under Socialism there can be no economic activity in our sense of the word. In small and insignificant things rational action might still persist. But, for the most part, it would no longer be possible to speak of rational production. In the absence of criteria of rationality, production could not be consciously economical. (1936, p. 119)

But while there remains little doubt that the Austrians vanquished their socialist opponents on the battlefield of ideas, the fruits of that victory have been few, for a simple reason. Orthodox comparative systems economists have long rejected the Misesian critique as clever but ultimately irrelevant, because it seemed obviously refuted by a historical counter-example—the real-world experience of the Soviet Union, not to mention China, Cuba, and numerous other Soviet-style economies, which, despite major endemic inefficiencies, appear to generate high levels of complex output by way of comprehensive central planning. In other words, the Austrians won the battle but lost the war because "socialist economies" *must* be possible (regardless of the Austrian critique), demonstrated by the fact that they actually exist.

The intention of the present article is to suggest an alternative analysis, one which is more consistent with the straightforward and uncompromising critique of socialist planning originally propounded by Mises. We will argue that the Soviet Union—and by extension, Soviet-style economies elsewhere—are not examples of *socialism* but rather modern examples of *mercantilism*. Such economies are "rent-seeking societies," in which the government controls, described as "central planning," in reality provide monopoly profits for a privileged minority at the expense of consumers in general. The ideological claims made by the beneficiaries of such policies may play a significant role in maintaining the stability of the system, but do not necessarily reflect the actual economic motivations of those beneficiaries. In short, Mises *was* right, whereas the usual ac-

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count of the "facts" involving the Soviet economy is confused and misleading.

Is the Soviet System a Planned Economy?

In *The State and Revolution* (1917), Lenin wrote:

> The whole of society will have become a single office and a single factory with equality of work and equality of pay. . . . we have a right to say with the fullest confidence that the expropriation of the capitalists will inevitably result in an enormous development of the productive forces of human society. (quoted in Polanyi, 1940, p. 27)

Lenin's conception of the Soviet-style economy as "one big factory" is generally shared by Western economists and Sovietologists. The Soviet economy is frequently referred to as the "U.S.S.R., Inc." Robert Campbell, a leading economic analyst of comparative systems, describes the Soviet-style socialist economy as " a kind of supercorporation charged with running the economy under unified management and for a centrally determined purpose."

The conventional analysis of the functioning of the Soviet economy can be briefly summarized. In the Soviet economy, official prices are not determined by the free play of market forces, but by bureaucratic fiat, and tend to be very inflexible over time. According to the Soviet government, prices are merely a bureaucratic accounting tool in an economy based on comprehensive "quantity adjustment" rather than the price adjustment typical in market economies. Most Western analysts take this assertion at face value. Furthermore, the "U.S.S.R., Inc." is supposedly insulated from the competitive constraints characteristic of market economies. Input suppliers are *assigned* to producers, and the planning board, not the consumer, is sovereign. As Svetozar Pejovich describes the system:

> The Soviet government allocates resources and assigns productive targets to all industries and firms in the economy. All decisions concerning the level and character of the economy flow from the top leadership through various bureaucratic channels down to productive units. The sum total of these administrative orders is the economic plan. The plan is a law of the land; and individuals who are caught interfering with the plan might be taken to court. (1976, p. 98)

The planning process supposedly works in the following manner. The party leadership sets objectives for the economy (specific levels of military output, consumer goods, etc.). The central planning agency (Gosplan) creates an economic plan designed to achieve these objectives for a five-year period, and assigns plan targets to industries and firms. One of the most pressing problems the planners face is the need to establish "material balances"—i.e., demonstrate that the plan's targets are consistent with existing productive capacity and resources. Balances are drawn up for all products; the balance for each input shows its sources and uses. Allocation of inputs to individual enterprises is determined on the basis of material balances and production targets (see *ibid.*, pp. 99-100, for a good summary of this argument).

This is what the Soviet regime says the planning agencies are doing, but there are reasons to doubt that the planning process actually works this way. In fact, there is a recurring debate in the comparative systems literature about whether the Soviet economy is "really" centrally planned. There is considerable evidence that much, if not most, of the supposedly "planned" sector is not *planned* at all, or at most "planned" after the fact. For example, Alec Nove (1977, p. 110), writes: "[in] practice, enterprises order material and equipment for next year in April-June of the current year, that is, 6-8 months before next year's plan becomes known." According to Birman (quoted in Wilhelm, 1980, p. 270): "[it] is correction of the plan during the process of its fulfillment that makes good the mistakes and miscalculations of the planners and averts many disagreeable consequences." The same author adds in a footnote: "[the] secret behind plan fulfillment by nearly all branches and republics of the annual plan for gross output is, in principle, that at the very end of the year the plan is changed to expected fulfillment." The annual plans are apparently amended quite frequently in order to

"better fit the conditions of particular enterprises." According to a sample survey covering 95 enterprises in the Novosibirsk area reported by *Pravda* on November 12, 1973 (cited by Nove, 1977, p. 103), in an average year these enterprises received a total of 1554 amendments to the annual production plan. As Nove notes, "the non-stability of norms is notorious." Elsewhere, Nove explains:

> [the essential point] is that in most instances *the centre does not know* just what it is that needs doing, in disaggregated detail, while the management in its situation *cannot* know what it is that society needs unless the centre informs it. Despite all the talk about reform and direct links, the fact remains that in a basically non-market model the centre must discover what needs doing, and the centre cannot do this in micro-detail. (1977, p. 105; italics in original)

Problems of this sort have caused some comparative systems analysts to insist that the Soviet "centrally planned economy" is not *literally* centrally planned in a complete sense, but rather that the central planning authorities set a broad agenda for economic production which permits much initiative on the part of management of actual productive units. Thus, Nove (1975, p. 136) argues that while the "centrally planned" economy may not be literally planned in detail from the center, the term is still useful, just as the term "absolute monarchy" is useful and descriptive in reference to the ancien régime, however literally inaccurate. In other words, the term "central planning" is most commonly used among experts on the Soviet economy as basically a figure of speech.[1]

This is clear in discussions of the so-called "ratchet principle." Briefly stated, this means that the plan issued to any given enterprise from Gosplan (the central planning board) via the relevant ministry will instruct the enterprise to produce at least as much of whatever it produces as it produced last period. The past year's output becomes a baseline for determining next year's planned output. There is extensive discussion in the comparative systems literature about the problems associated with this method (e.g., perverse incentives confronting managers; see Berliner 1976, pp. 65-67, and Pejovich 1976, pp. 99-102). A more fundamental point is usually neglected. A method of "planning" which is based on simply directing enterprise managers to maintain output at previous levels is equivalent to planning after the fact, and bears little relationship to the stylized models of central planning offered in many comparative systems textbooks.

So, we are left in a quandary. Mises and Hayek demonstrated that a centrally planned economic system is impossible. Furthermore, the conventional wisdom among students of the modern Soviet economy is that comprehensive central planning—the point at issue in the socialist calculation debate—is not practiced in the Soviet Union (and, by implication, in the numerous nations which have adopted the "Soviet model" in whole or in part). Yet the Soviet economy is alive (if not well), and the Soviet economic model is widespread and popular among dictatorships throughout the world. The remainder of the present article will attempt to articulate an alternative theory of the "socialist" economy which is both consistent with the known facts *and* with the Misesian critique of the impossibility of central planning.

The Soviet Economy as a Mercantilist System

As we have seen, the Soviet economy is clearly not centrally planned in the strict sense. Even among Western experts in comparative economic systems, the notion of "planning" applied to the Soviet economy is extremely murky. The consensus judgment seems to be that the Soviet economy is characterized by a very high level of government intervention, but that at best only a relatively small portion of the overall economy is centrally planned in any detail. It is unclear how this situation can be economically distinguished from a case where the government in a country with a market economy controls a large "nationalized" sector.

Also, scholars of the Soviet economy widely recognize that "central planning" is, practically speaking, observed mostly in the breach. Nevertheless, it is commonly asserted that virtually the entire Soviet economy is centrally

planned (e.g., see Kaiser, 1984, p. 344). Presumably, this means that central planning—whatever it is in practice—is technically applied to the entire economy. But in fact, there is a substantial private sector in the Soviet economy. This is a segment of the economy which is not, even in the loosest sense of the term, "planned." The comparative systems literature often mentions the importance of private agriculture (on small, privately owned agricultural plots) in overall agricultural output. However, this is only the tip of the iceberg. The "parallel" or "second" economy, comprising economic activities which are illegal or quasi-legal, may be very large. Various estimates of its size range from 10 per cent to 40 per cent of GNP. This is in addition to the legal private economy (e.g., private farm plots) which probably contributes between 10 and 20 per cent of GNP. A recent RAND Corporation report prepared for the Department of Defense, which probably understates the level of activity in the "second economy," estimates that, on average, 11.5 per cent of total household income in the U.S.S.R. came from private sources. This study also estimates the average share of family expenditures made in the "second economy" to be 18 per cent. One scholar estimates the share of the "second economy" throughout the U.S.S.R. as 25 per cent for alcohol distillation, 80 per cent for fur production, 61 per cent for domestically consumed fish, and (in Moscow) 70 per cent for home repairs and decorations (see O'Hearn, p. 226). The second economy is relatively more important in certain areas of the Soviet Union. For example, in Kazakhstan, an estimated 80 per cent of petrol and lubricants was supplied outside of "official" channels; in Georgia, at least 98 per cent of house repairs and 97 per cent of appliance repairs are supplied by the second economy.

But in an important sense, it would be false to claim that this "private sector" can be sharply distinguished from the "planned sector." Much of "second economy" activity is based on evasion of legal entry restrictions.

Legal monopolies in the form of entry restrictions are pervasive in the Soviet economy. According to Berliner (1957, p. 408): "The central planning system, with its ministerial organizational structure drawn on industry lines, has tended to erect barriers against invasion. If the same barriers prevail . . . the possibility of invasion would continue to be remote. Producers would be expected to restrict their horizons and not poach on the markets of others."

Nove (1977, p. 116) elaborates further: "A key factor [in the Soviet economy] . . . is the sellers' market plus monopoly. In an economy of shortage, the supplier is powerful. He can insist on his own terms . . . [the] monopoly element is provided not merely by the fact that the state owns all of industry, since without state ownership one would still have a competitive situation, but particularly because the customer . . . is not allowed to go elsewhere."

Legal Controls on Price Competition

The most important restrictions are the legal controls on price competition. This is generally considered the hallmark of a socialist economy: market economies may have very large public sectors, but can only become socialist when they abolish the free market price system.

Of course, according to the conventional wisdom, the central planning authorities use a sort of price system, but one in which all prices are set by the planners. Prices are strictly an accounting tool, and are not designed to reflect relative scarcity of resources. Some economists have described the Soviet economy as not monetary but "documonetary," in which money serves an accounting function, but cannot actually command resources—documents issued by the central planning authorities are necessary to do so. According to Berliner (1976, pp. 88-89), the producer is forbidden by law from selling a commodity to a purchaser who does not possess an allocation certificate; allocation certificates are issued by the supply planning agencies and are needed for most important purchases.

However, in the Soviet-style economy (as in Western economies during periodic episodes of governmental price control) *official* prices do not necessarily correspond to *effective* prices in actual exchange. As was the case in the United States during World War II and in other historical examples of governmental price controls,

effective prices (i.e., "black market prices") appear to be flexible, despite the fixity of official prices.

In economics, monopoly is analytically significant only in those cases where there are associated monopoly rents (profits accruing from a monopoly). But while many comparative systems analysts recognize the existence of extensive monopolistic restrictions in the Soviet economy, they overwhelmingly eschew the next logical step in the analysis: what happens to the monopoly profits we expect to find associated with such restrictions on competition?

The simple answer appears to be that monopoly profits flow to those officials in the fortunate position to transfer resources from consumers to themselves. Simis (1977, p. 149) reports that the deputy director of the supervisory board of the Ministry for the Automobile Industry and his close associates countersigned requisition notes for the supply of vehicle parts at a rate of 1,000 rubles per requisition (i.e., about three months' official pay for the average Soviet worker); moreover, their regular clients rented a flat in Moscow for the Ministry officials to hold parties and orgies in. In another incident, the deputy director and chief engineer of a construction trust supplying state farms with building materials received between 20,000 and 40,000 rubles from each farm the trust had dealings with, in order to expedite deliveries. In another case, an official in the Novolipetsk Metallurgical Combine took large bribes for many years (which included such items as cases of champagne and a complete kitchen range) for releasing supplies of metal against dispatch notes.

In 1964, a KGB investigation revealed that the entire leadership of the government and Communist Party in Kirghizia, headed by the First Secretary of its Central Committee and the Chairman of its Council of Ministers, had been in the pay of a gang of underworld racketeers for a number of years. The latter allegedly had set up an extensive network of dozens of clandestine factories, collective farms, and plantations of opium and cannabis, the income from the sale of which was split with the officials. Interestingly, in this case only the underworld gang and one junior deputy minister were eventually brought to trial (*ibid.*, p. 146).

Voslensky (1984, p. 191) reports that in the early seventies, the President of the Supreme Soviet of the Soviet Republic of Azerbaijan sold pardons to convicted felons, and charged 100,000 rubles in cases involving long imprisonment. In the same period, the Azerbaijani Communist Party allegedly sold appointments to various positions in government for large sums: 30,000 rubles for District Public Prosecutor, 50,000 for Chief of the District Militia, 80,000 for manager of a Sovkhoz collective farm, and 200,000 for appointment as First Secretary of the Party District Committee.[2]

Paying the "Price" of Admission

According to Grossman (1977a, pp. 32-33), admission to academic institutions in the Soviet Union is often accomplished by way of bribery. The "price" of admission varies with the quality of the institution, and also varies across republics. The scale of bribes necessary to secure admission to the universities in Moscow and Leningrad varied between 1,000 and 3,000 rubles, but admission to the medical institute in Georgia cost 15,000, and in Azerbaijan, 30,000 rubles.

There seems to be no way of accurately estimating the magnitude and extent of such activity in the entire Soviet system. We recognize that these examples, and many others we could add, must in each individual case be treated cautiously, because they are derived from reports in the official Soviet press. Ostensibly such activities are illegal, and the official press publicizes such examples to deter potential wrong-doers. In reality, a number of observers have noted that high officials accused of corruption normally go unpunished. The individuals whose corruption becomes the subject of articles in *Pravda* may be only those who have somehow acquired enemies more powerful than themselves. By the same token, stories of corruption reported in the Soviet press may sometimes be entirely concocted by the KGB at the behest of Soviet rulers, and may only represent a glimpse into a secret power-struggle.[3] The examples are not intended as empirical evidence—which may be unobtainable even in principle for obvious reasons—but

simply as illustrations of rent-seeking (the pursuit of monopoly profits) that we would predict is probably widespread.

A plethora of similar examples could easily be added.[4] Officials in command of particular entry barriers in the U.S.S.R. are in a position to obtain profits resulting from the exercise of coercive restrictions on competition in the form of bribes, which are sometimes of enormous size. In the Soviet system, entry into competition is technically prohibited, but can be achieved—but only by "paying off" the enforcers of the restrictions. The extensive and elaborate system of "fixed (official) prices" represents opportunities for profits from actual bribery, and also from artificially increased prices creating gains in the form of legal monopoly revenue increases to favored producers. The examples listed above involve monetary bribes, but bribes in the form of transfers of goods and services (and "favors") are probably more important and more widespread, because they are inherently more difficult to trace. Grossman (1977b, p. 841) argues that simple bribery is relatively uncommon, but regular tribute is normally paid to those in positions of bureaucratic power by those subject to that power, and that this in-kind tribute is easier to conceal.

The system of officially "fixed" prices offers numerous opportunities for blatant profiteering on the part of officials who are assigned to administer the economic controls. The officials in charge of issuing the necessary documents to command resources can potentially gain a significant increase in their income by marketing these documents to the highest bidder. An example of this kind of market evasion of price controls which has received a notable amount of attention in the Western press is the illicit marketing of above-minimal quality medical care to patients by doctors, in the context of ostensibly "free" hospital services.[5]

This system, dominated by the pursuit of monopoly profit on the part of privileged producers and officials (the beneficiaries of the extensive economic controls and regulations), bears little resemblance to the idealized vision of a centrally planned economy (which in any event Mises and Hayek proved to be impossible). Instead, it closely resembles a real-world economic system which has received much attention from historians: the mercantilist economy of France under Louis XIV. Under the mercantilist regime, most production of marketable output was extensively regulated by the central government, and regulations were enforced by paid civil servants called *intendants*. These regulations were overtly designed to enforce barriers against competitive entry, and the monarchy openly sold regulations as cartel enforcement services. According to Ekelund and Tollison (1981, p. 88), revenues from the sale of these regulatory entry barriers were the chief source of revenue to the monarchy.

Of course, the regime which imposed this detailed system of controls on the economy in France was the same regime that built the opulent palace of Versailles and maintained by far the largest standing army in Europe. Mercantilism in pre-revolutionary France was established on frankly venal grounds, and was not overlaid with any significant ideological facade. It was simply a means by which the monarch raised revenue.

Mercantilist France and the Modern Soviet Economy

Many scholars argue that this system of extensive and detailed mercantilist controls suffocated the incipient industrial revolution in France (see North and Thomas, 1973). Heckscher argues that the major difference between England and France that helps to explain why the Industrial Revolution took place much earlier in England was that England had a relatively weak and poorly enforced system of mercantile regulations, while those in France were very strong and robust. (Ekelund and Tollison, 1981, Chapters 3 and 4, make this argument in much more detail.)

There are a number of important differences between the system of mercantilist regulation in France and the modern Soviet-style economy. There was no central planning bureaucracy, or anything remotely resembling it, in seventeenth-century France. The Soviet Union employs an army of special troops to seal its borders to potential emigrants, whereas the government of France made no such effort.

The French monarch sold legal monopolies

and many positions of regulatory power to the highest bidder. In the Soviet Union, positions of significant regulatory authority and control of legal monopolies ostensibly are assigned by the Communist Party on the basis of loyalty and merit. Managers of enterprises, officials in the Party and the central planning apparatus, as well as almost all other official positions—those which potentially provide access to significant income in the form of bribery and other forms of corruption—are selected from approved lists (*nomenklatura*) that are drawn up by the Communist Party and the KGB.

We know very little about the process by which the membership in the *nomenklatura* is determined. Voslensky (1984, p. 76) argues that loyalty to the Communist Party and political reliability are critical factors in the criteria for selection of candidates. It would be very surprising if the Soviet regime did not act to ensure that those in positions of economic power were not threats to the regime. Given the widespread benefits, pecuniary and non-pecuniary, associated with membership in the *nomenklatura* which several writers have detailed (ranging from permission to shop in stores carrying high quality goods to actual bribes, or *blat*), we would predict that potential members would bid competitively for such opportunities. Unfortunately, we have little recourse to informed speculation concerning this process. Non-pecuniary bribery is evidently a common route into the ranks of the *nomenklatura,* and there is some evidence that membership is increasingly becoming a de facto hereditary privilege, with parents insuring that their children also become members (*ibid.,* pp. 100-102).

In the case of mercantilist France, the "purchase price" of a monopoly restriction or official office would ultimately flow to the monarch; the *intendant*-enforcers were simply the paid agents of the autocrat. The situation is unlikely to be so simple in the U.S.S.R. It seems unlikely that a successful candidate for manager of a tractor factory sends an envelope full of cash to the General Secretary of the Communist Party.[6] There are reasons to believe that there may be several competing power centers in the Soviet state (the Soviet regime is sometimes described as a "troika" composed of the Communist Party, the KGB, and the military), which would make the system of Soviet "mercantilism" inherently much more complex than that of pre-revolutionary France. But the basic similarity remains.

The *nomenklatura* may play an important role in perpetuating the system in the face of massive economic inefficiency generated by the extensive restrictions on market exchange. The *nomenklatura* functions as a large, powerful, highly organized and cohesive interest group whose members benefit significantly from the present system, which they basically control. The Soviet consumers are greatly harmed, but face extremely high organization costs (e.g., the KGB). The often-reported continuing struggle of the KGB against "dissidents" can be interpreted as the (successful) efforts by the interest group composed of the *nomenklatura* to prevent the effective organization of consumer interests.

Two Types of "Second Economy" Activity

In this context, it is necessary to distinguish between two types of "second economy" activity. That which represents the exploitation of monopoly positions by the officially appointed holders, or franchisees, is the form in which monopoly profit (or rent) is extracted from consumers. For example, the monopolist shoe producer cannot raise the official price of shoes, but he can extract surpluses from consumers by requiring "extra" unofficial payments, or bribes, from them. The other major form of underground exchange involves the attempts by outsiders illegally to enter into competition with established monopolists, e.g., the private shoe producer who competes with the State shoe factory. This second category also would include cases of agent-principal problems, where the employees of State monopolists divert rents to themselves illicitly (e.g., a clerk at the Univermag department store who restricts the sale of high-quality items to "special" customers who pay him or her a bribe on the side). Both types of activity indicate the degree to which market exchange, without even the pretense of "planning," characterizes the Soviet economy in practice, even though only the first type is relevant to understanding the purpose of

the system from the perspective of the Soviet leadership.

It is widely recognized (cf. Andrle, 1976, Conyngham, 1973, and Hough, 1969) that the Communist Party plays a very active role in the Soviet economic system. The Party maintains a large supervisionary apparatus which oversees the operation of enterprises, and is chiefly responsible for the selection of managers.[7] Andrle (1976, p. 102) explains that Party "industrial instructors" monitor closely, and actually participate in, enterprise decision-making.[8]

What has not been recognized is the high degree of similarity between this set of Party functions and the function of the *intendants* in the French mercantilist system around the time of Colbert. Any system of monopoly restrictions requires enforcement to prevent illicit competition from dissipating the monopoly rents and rendering the monopoly rights worthless. In mercantilist France, the *intendants* system was designed to accomplish just that. *Intendants* were detailed to monitor markets in local areas and sanction illicit competition (see Ekelund and Tollison, 1981, pp. 85-91).

Illicit competition may tend to take another form—official enterprises may begin to compete with one another, improving consumer welfare but at the same time lowering the profits which the state-sponsored cartels can earn in the long run. A system of *intendants* could help to solve this "problem" as well. A system of industrial inspectors ("snoopers") may help to prevent firms from undercutting the official cartels by offering lower priced goods, producing more or different goods than assigned by the relevant ministry, and in general behaving competitively.

In fact, this may be the basic function of the "central planning apparatus"—the army of bureaucrats and officials who purportedly administer the economy from the center in excruciating detail. The socialist calculation debate aside, as we saw previously, there is ample evidence that the central planning bureaucracy only "plans" after the fact anyway. However, this suggests an alternative possibility. The central planning bureaucracy may be simply an enormous system designed to coordinate the activities of numerous cartels of producers in the economy. As we have seen, much of the economy is organized by the state in the form of producer cartels, and the central administrators of the regime face a peculiar problem: how can the various different cartels be prevented from competing with one another? Even if competition can be effectively controlled among the enterprises within a particular cartel, it might still be possible for various cartels to compete with other cartels by offering competing products and services. The "central planning" system may be only a device designed to detect and control such illicit competitive behavior on the industrial level; perhaps preventing the Metallurgy Cartel from competing with the Plastics Cartel, or the Chemical Cartel from competing with the Textile Cartel. Thus, the vaunted "central planning" bureaucracy may only represent something extremely mundane, albeit economically understandable: the central office of an elaborate system of interconnected industrial cartels in the economy.

Summary and Conclusion

This article has argued that the Soviet-style economic system is in actuality not a "socialist" economy at all, but a highly restricted market in which state intervention is almost completely unrestrained by force of law, constitution, or concern for electoral support. Like the mercantilist system in seventeenth-century France, the Soviet economy is characterized by widespread restrictions on competition designed to provide monopoly rents to a favored few. The name of the game is not "rational economic planning," but rent-seeking. The alleged "central planning system" appears to function as a monitor and enforcer of compulsory cartel agreements engineered by the state; the "planning" apparatus functions to protect the holders of monopolistic privileges from the competition of outsiders and also to defend and maintain the monopoly rights from encroachment by *other* monopolists. In this sense only does the "planning system" perform a kind of planning function: it coordinates among different monopolistic enterprises in the sense that it minimizes competitive conflict among them.[9]

Numerous observers of the Soviet system have declared that the ideology of Communism plays no important role today, whether or not it

ever did.[10] The argument presented here might seem to imply this—but only in relation to those wielding effective political power in the Soviet regime. Ideological commitment to the goals of Marxian socialism may play an important role in bolstering the control of the regime over the general population, as well as protecting a system of mercantilism, which greatly harms the welfare of consumers, from a rebellion by those consumers. Certainly, the regime invests enormous resources in the production and distribution of domestic propaganda; Heller and Nekrich (1986, p. 656) maintain that "the ideological army"—the bureaucracy devoted to propaganda—"surpasses the army, navy, and air force in number." Even if the ideology of socialism is not a primary motivating factor behind the existence of the Soviet economy, it undoubtedly plays an important role in maintaining and perpetuating that regime.

However, we need not assume that the present system is organized by those in power based solely on some fervent commitment to socialistic ideals, without regard to the reality of socialist economic performance. The "ruling class" in the Soviet system are the beneficiaries of a system which generates enormous profits for the few in charge by means of massive governmental restrictions on the process of free competition. □

FOOTNOTES

1. In his recent study of the Soviet economy during the Stalin era, Eugene Zaleski notes that this has been the case since the early 1930s. He writes: "[this] study shows that the existence of . . . a central national plan, coherent and perfect, to be subdivided and implemented at all levels, is only a *myth*. What actually exists, as in any centrally administered economy, is an endless number of plans, constantly evolving, that are coordinated *ex post* after they have been put in operation. The unification of these innumerable plans into a single national plan, supposedly coherent, takes place rarely . . . furthermore, the attempt at unification is only a projection of observed tendencies resulting from extrapolating trends based on natural forces." (1980, p. 484)

He goes on to describe the nature of the plans as "changing and often ephemeral" (*ibid.*).

2. Willis (1985) explains: "High office is often a passport to riches in the three republics of the Caucasus and the five in Central Asia. Large bribes have been reported given to Party officials to extract important *nomenklatura* appointments: the job of Party leader in a district committee had been secured by the payment of between 150,000 and 200,000 rubles to a republican Central Committee functionary in Georgia and Azerbaijan. The position has cost 100,000 rubles, and the job of minister for trade, who controls all retail shops, went for 250,000 rubles." (p. 308)

3. For example, on December 16, 1986, the Chairman of the Communist Party of the Soviet Republic of Kazakhstan, Dinmukhamed Kunaev, was replaced by Gennadi Kolbin following publicity concerning Kunaev's alleged corruption (e.g., private herds of sheep, cattle, and horses on state farms kept for members of the top Kazakhstan leadership, and large sums supposedly taken from state coffers to equip private hunting lodges with saunas, billiard halls and crystal candelabra). This replacement was touted as part of Gorbachev's "anti-corruption" campaign. However, it is also the case that the unfortunate Kunaev was a friend and follower of the late Leonid Brezhnev, and that the luckier Kolbin is a friend and follower of Mikhail Gorbachev. It seems a reasonable guess that if Kolbin had been Party Chairman and had pursued Kunaev's interest in cows and billiards, the Gorbachev campaign against "corruption" probably would have looked somewhere else. See Bohlen (1987, p. 1).

4. Harris (1986, pp. 24-30) lists numerous examples of "socialist graft" (extraction of monopoly rent by those in official positions) in the People's Republic of China, which are generally similar in nature to the examples from the Soviet Union cited above.

5. In practice, enterprises in the Soviet economy normally depend on the services of second economy operatives, known as *tolkachi* (literally, "dealers") who overcome supply problems by the use of bribery and/or *blat* (non-pecuniary bribes such as favors, presents, etc.). The *tolkach* of the enterprise in effect markets its output and purchases the output of other firms "under the table." Although the magnitude of this activity is impossible to measure precisely, the *tolkachi* seem to play an extremely important role in the economy. Berliner (1957, p. 224) quotes the head of a food-processing combine he interviewed as declaring of the *tolkach* that "[he is] irreplaceable. We live with him as if in Christ's bosom." For discussions of the *tolkachi* and their importance, see Berliner (1957, pp. 220-231; 1976, pp. 73-76), Kaiser (1984), and Nove (1977).

6. However, it apparently is the case that the top leadership not only retains ultimate authority over the selection of personnel for both governmental and industrial posts (managers, etc.) but sometimes even makes the actual selections. For instance, Stalin is known to have often directly selected relatively low level personnel. See Goldman (1983, p. 22).

7. The Communist Party excercises control over managerial appointments in a number of ways. Every Communist who changes his job can do so only with the approval of his "raikom" (Party district committee). In the Soviet Union the majority of enterprise managers are members of the Party; it is highly unusual for a manager of any but the smallest enterprises not to be. Every Party organization is responsible for creating a "managerial reserve," that is, a list of people who are potentially "suitable" for managerial careers; and Party organs have the right of veto over all appointments made to posts listed in the *nomenklatura*. See Hough (1969, Chapters 1 and 2), and Voslensky (1984, Chapter 3).

8. Andrle (1976, p. 102) quotes a 1968 Soviet official publication's description of the activity of industrial "instructors" of the Communist Party: "Preparing reports for the bureau and the plenum, sending trucks to a harvest, organizing city celebrations and improving city amenities, procuring supplies for enterprises . . . and hundreds of other problems have to be dealt with without delay. One plant needs help with the overhaul of a motor because it has no suitable workshop; another needs a big boiler transported, but the necessary cranes and vehicles are in the possession and intensive use of building organizations . . . [etc., etc.]"

9. This is consistent with Voslensky's interpretation of the Soviet system. Arguing that the Soviet economy is a "syndicate," or an "ultramonopoly" created by State coercion, he writes: "The nomenklatura class exercises unlimited sway over the huge syndicate of which the Soviet economy consists. That is the principal feature of the country's economic organization. *Nevertheless, the outside world goes on believing that its chief characteristic is economic planning.*" (1984, pp. 127-128; italics added)

10. For example, Nove (1977, p. 10) writes: "Probably most analysts would agree that ideology (i.e., Marxism-Leninism) is not a powerful force in the Soviet Union today."

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Peking Duck or Kentucky Fried?

by Lawrence W. Reed

Mao Tse-tung, the man whose 1949 revolution brought communism to China, once launched a nationwide "Four Pests" campaign. Part of the effort was designed to eradicate houseflies by having every Chinese meet a quota of swatting at least 10 flies a day.

Now years later, as the "Great Helmsman" rests in peace in Beijing's Tiananmen Square, China still has plenty of flies. But something that would undoubtedly disturb Mao far more, if he only knew it, is on view just across the street from his mausoleum: the smiling face of Colonel Harlan Sanders.

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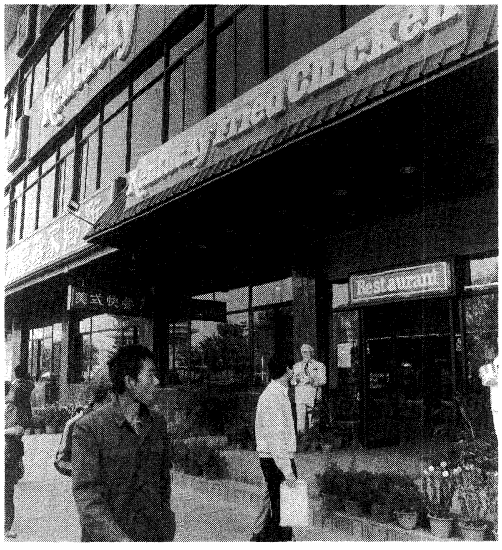

KENTUCKY FRIED CHICKEN/BEIJING

In November of 1987, Beijing became the site of the world's largest Kentucky Fried Chicken restaurant. The 500-seat fast-food eatery is the latest monument to the policies of Deng Xiaoping, under whose leadership post-Mao China has been moving away from three decades of radical isolation and doctrinaire Marxist control of the economy. In Beijing, at least, *glasnost* is finger-lickin' good.

Store manager Khaw Swee Kwang reports the place serves an average of 1,000 meals on weekdays and nearly double that on weekends. Two- and three-piece chicken dinners sell at prices comparable to what Americans pay here. The chain is negotiating with the government to open other outlets.

Strict quality control assures the taste is no different from that in the American outlets.The chickens are raised on farms outside the capital to Kentucky Fried Chicken's exacting specifications. Ditto the potatoes and cabbage. Only the famous "11 herbs and spices," a trade secret, are imported.

In an interview, Khaw made it plain that running such a capitalist establishment in a communist country has been profitable but not easy. The Chinese government, for instance, insists on majority ownership. Kentucky Fried Chicken's share is limited to 40 per cent.

The management must eventually be predominantly Chinese. Khaw himself is from Singapore (which boasts 31 Kentucky Fried Chicken outlets) and will leave Beijing when his mission to train Chinese managers is completed.

Workers drawn from the local labor pool present a major challenge. The so-called "iron rice bowl," a Maoist notion that each worker should have a secure, lifetime job (an unbreakable rice bowl), has become so much a part of Chinese life that workers must be taught that merely showing up for work is not enough. They must learn a new ethic centered around the capitalist notion that "the customer is always right."

"It's always been difficult to teach them to really care, to go the extra mile in keeping customers happy," Khaw says. By prior arrangement with the government, the restaurant is permitted to fire unsatisfactory employees. The mere prospect, according to management, has been a "powerful incentive."

Employee wages are fixed by the government, which is anxious to avoid being embarrassed by a foreign capitalist enterprise's paying more than its domestic counterparts. Because high morale and better performance incentives are important to Kentucky Fried Chicken, the management has found the low-wage scale too stingy and restrictive. The problem is partly circumvented with occasional bonuses "paid" in fried chicken.

The restaurant is also experiencing another problem, the same energy hassle that afflicts all buildings in Beijing. The state-owned utility refuses to supply any heat before November 15. It's shut off on March 15 regardless of the weather. The city often endures below freezing temperatures into April.

Patrons like the restaurant not only for the food and the colorful, well-lighted surroundings, but for its American aura as well. More than a few will tell the visiting foreigner that eating there is as close as they are likely ever to come to fulfilling their dream of seeing the United States.

Somebody once said the formula for rolling back the communists calls for bombarding them with capitalist mail-order catalogs, video tapes, and fast food. If so, Colonel Sanders may be one of America's more cost-effective weapons. □

Perestroika: Can It Work?

by Manuel F. Ayau and Julio Cole

It is all very well to hail *perestroika*—the current moves toward liberalization of Soviet bloc economies, the establishment of "profits" as incentives for Soviet managers, and steps to organize Soviet production is a more businesslike manner. But all these changes soon will bring disappointment, for technical reasons.

It isn't enough to imitate the marketplace. The essential ingredient of a market economy is the private ownership of scarce resources and the means of production. And even with *perestroika* this ingredient is missing.

The technical reasons have to do with a problem which continues to be ignored by most people, and indeed by most economics professors. In the 1930s, when it was debated in small intellectual circles in Europe, it was called the Problem of Economic Calculation.

Simply stated, we live in a world of scarcity, and no matter how a society is organized, we always will need some means of deciding how resources can be put to the best use. In a capitalist society, free market prices provide the answer. Competition among buyers and sellers in a free market established relative prices which eliminate the least economic (least profitable) uses of each particular unit of a resource, inducing the use of substitutes which in turn must be withdrawn from other uses by the same marketplace process. All of this happens only because resources and the means of production are privately owned—they can be bought and sold and consequently have market prices. How this happens is amply explained in economics texts, although seldom are students reminded that it happens only in economies with private ownership.

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Problems of Allocation

What has yet to be explained is how a true socialist society (one that doesn't copy capitalist prices) could carry out this necessary task of efficient allocation. Ration cards, queues, and income controls are used today in so-called socialist countries, along with arbitrarily determined shadow prices, to ration consumer goods. But how would the planning czar determine how best to use, say, one additional pound of silver when confronted with such competing uses as more X-ray film, industrial film, microfilm for banks, tourist film, jewelry, electronic contacts, tooth fillings, and wart removals? Remember that he also would have to decide on the price relationships of all the inputs used to produce the pound of silver, as well as the prices of all the things of which it becomes a part. And we must bear in mind that he cannot simply sum up the costs, since costs themselves are prices.

The problem of economic calculation was brought to the attention of the academic community by Ludwig von Mises in 1920. In referring to Mises, the famous socialist theoretician Oskar Lange wrote in 1936, "it was his powerful challenge that forced the socialists to recognize the importance of an adequate system of economic accounting to guide the allocation of resources in a socialist economy. Even more, it was chiefly due to Professor Mises' challenge that many socialists became aware of the very existence of such a problem. . . . the merit of having caused the socialists to approach this problem systematically belongs entirely to Professor Mises. Both as an expression of recognition for the great service rendered by him and as a memento of the prime importance of sound economic accounting, a statue of Professor Mises ought to occupy an honorable place in

the great hall of the Ministry of Socialization or of the Central Planning Board of the socialist state."[1]

The nature of the problem of economic calculation is that of assigning relative prices to millions upon millions of items, each of whose price is a function of all other prices, with the ultimate deciding factor for each price being the ever-changing subjective valuations of millions of consumers.

Though it is sometimes useful conceptually to represent the economic problem as a system of simultaneous equations, solvable "in principle" by an omniscient central authority, it is utterly naive to assume that even the simplest problems could actually be solved even in this era of supercomputers. Toward the end of the last century, Italian economist Vilfredo Pareto showed that a simple "economy" involving only 100 people and 700 goods required the solution of 70,669 equations. The fantastic number of equations involved in the more realistic case of millions of people and millions of goods is mind-boggling. And this mathematical approach completely overlooks the subjective and therefore unmeasurable nature of consumer valuations, as well as the critical role of entrepreneurs who strive to discover and meet changing consumer needs and wishes.

Even assuming that the "Central Authority" could paternalistically decide upon the proportions of final consumer goods to be produced (i.e., how much of each commodity is "good" for the people), the main problem is how to produce the desired outputs—determining which of the myriad of technically feasible input "mixtures" is most efficient. The fact that the leading Soviet planning theorist, L. Kantorovich, managed to discover the problem in 1939 is one of the most curious incidents in the history of modern economics. He found that the correct solution of a production problem given several inputs and several possible input combinations, required the introduction of certain auxiliary variables which he called "allocation coefficients." As it turned out, when Western economists read his paper after the war, they realized that these "allocation coefficients" were simply the prices of the different inputs.[2]

Because we live in a world where things have prices, we take them for granted. But market theory teaches us that prices are not established by "someone" or by some "authority." They arise from private exchange decisions made at the margin. It is the marginal buyer and the marginal seller who determine the market-clearing price. Socialist economic theory is based on the principle that values are objectively determined, so there can be no such thing as "the margin." The concept of "marginal rates of substitution" can have meaning in the determination of prices only where resources and the means of production are privately owned. And this excludes socialism.

What this boils down to is that no one has ever explained how socialism is supposed to work. (As an aside, it is worth noting that this is a very disturbing and serious matter, when one thinks of an academic world that grants recognition and prestige to people who unabashedly claim to be in favor of a system yet to be described!) Just because some totalitarian countries call themselves "socialist" does not mean that they actually operate in a socialist manner. If you are wondering how "socialist" countries go about setting their prices, it is simple: they copy them from capitalist countries, from Sears' catalogues, and from newspapers, adjusting them to their current plans. And whereas profit incentives are important motivationally, they are useless if decision makers lack the information to be able to economize resources and achieve efficiency.[3]

Myths die hard, and the myth of the feasibility of central planning is no exception. Failures will be blamed on people, on sabotage, and on the weather. Revolutionary new corrective measures again will be announced. Stay tuned: the new *perestroika* is coming. □

1. Oskar Lange and Fred M. Taylor, *On the Economic Theory of Socialism* (New York: McGraw-Hill, 1964), pp. 57-58.

2. Kantrorvich had stumbled upon the technique of linear programming, which in the meantime had been independently discovered in the West by G. Dantzig and T. Koopmans, where it has been successfully applied to a wide variety of management problems. Ironically, it has been applied in socialist planning, for one simple reason. Linear programming is a way to determine the most efficient solution of a production problem for a given set of input prices. Of course, for any arbitrary set of prices there is a corresponding "best" solution. However, there is no way of knowing whether this "best" solution is in fact the true optimum unless the original input prices themselves are optimal.

3. For a detailed treatment of the problem of economic calculation, see Don Lavoie, *National Economic Planning: What Is Left?* (Cambridge, Mass.: Ballinger, 1985).

How to Solve the Debt Crisis

by Christopher L. Culp

The world is in the midst of a debt crisis, though much of the U.S. financial sector has employed extensive rhetoric and artful accounting to avoid admitting it. The world first became aware that there was a problem when the Mexican government informed American banks in August 1982 that it was unable to pay the interest on its loans. By 1987, the problem had compounded. Peru had proclaimed that it would devote no more than ten per cent of its total export earnings to interest payments, and several countries such as Bolivia and Brazil, in effect, had defaulted.

The U.S. financial sector greatly fears the word "default," so it employs tidy euphemisms such as "restructure" to avoid acknowledging that most debtors cannot repay their loans. American banks might do well to remember the proverb: If a bank loans out a thousand dollars and the debtor defaults, the debtor is in trouble; but if a bank lends a hundred million dollars and the debtor defaults, the *bank* is in trouble.

If a bank holds more liabilities than assets, there is a risk of bank insolvency precipitated by "confidence problems." When a debtor nation refuses to pay interest on a loan, it makes it impossible for the lending bank to balance its account. However, to avoid taking losses, banks have engaged in the deceptive process of manipulative accounting. If a debtor nation owes a bank $50 million in interest and the country cannot pay it, rather than writing off the loan as unrecoverable, the bank lends the debtor $50 million more to pay off its interest obligation. However, there is interest on that additional loan. Since the debtor could not make the interest payment in the first place, there is little reason to think that it will be able to pay the interest on the additional loan, much less the premium. The ensuing cycle is painfully obvious.

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Unsustainable Debt

Unsustainable debt seems to be the case more often than not in the Third World. This problem is magnified by the fact that most lending institutions within developing countries are plagued by problems of illiquidity and insolvency. This financial crisis causes a serious distortion in the incentive structure for the Third World financial sector, in many ways similar to the recent U.S savings and loan debacle. Once a lending institution is insolvent, it is apt to take greater risks and make more questionable loans. This only aggravates concerns about bankruptcy or bank bailouts. Continued uncertainty inevitably leads to further financial crises as investors begin to doubt the ability of banks to provide liquidity.

Sir Alan A. Walters, former Economic Advisor to British Prime Minister Thatcher, describes this problem as "absolutely critical" because it makes the debt dilemma increasingly harder to solve as time goes on.[1] Furthermore, developing nations are typically becoming more heavily indebted without showing signs

of significant capital growth. From 1982 to 1986, gross capital formation as a per cent of GDP in heavily indebted countries dropped from 22.3 per cent to 16.8 per cent. At the same time, the debt-export ratios of these indebted countries rose from 269.8 to 337.9.[2]

As if the duplicity evident in the official balance sheets of many U.S. banks wasn't enough, the American financial sector has been recklessly irresponsible in its lending practices. Many banks have loaned far more than their equity. Consequently, when debtors cannot make their interest payments, such banks' liabilities will become greater than their assets. Their resulting insolvency will leave these banks unable to guarantee the assets of American investors. Enter the Federal Deposit Insurance Corporation, to rescue the failed banks. But what happens if, unlikely though it may seem, all the debtors default and their creditor banks become insolvent? The entire U.S. financial infrastructure is threatened.

Obviously, the U.S. financial sector wants to avoid this overly pessimistic scenario. Rather than face reality, though, American lending institutions simply resort to a policy of dishonorable accounting to temporarily alleviate the imbalance between assets and liabilities. However, the banks are only fooling themselves. Creative bookkeeping may work in the short term, but the problem of increasingly unsustainable loan exposure will continue, necessitating a solution at some point in the future when the problem is much greater.

Not all U.S. banks have perpetuated the illusion that all is well. John Reed of Citicorp decided in May 1987 to write-down his institution's Third World loans to their actual value and simply absorb the loss. He then increased Citicorp's debt-to-reserve ratio. Reed's actions were six years late in coming, but by June 1987, 43 of the 50 largest U.S. bank holding companies had engaged in similar measures.

Citibank took an important step in starting to pull the U.S. out of the debt crevasse, but its actions and the subsequent actions of other banks cannot solve the crisis. To avert a Third World debt "disaster," it is necessary to address the underlying issue of irresponsible lending *and* to stimulate growth in developing countries. While irresponsible lending is certainly a problem in the short term, it is the much greater problem of Third World underdevelopment that makes the debt crisis intractable under current systemic constraints. The most obvious solution to the crisis, then, is to facilitate development in less developed countries and improve their ability to repay their debt obligations.

The private sector not only provides a means of averting a short-term disaster, but addresses the far greater need of preventing future crises in lending. Three key measures will quell the financial storms and brighten the lending horizon: (1) securitization of outstanding U.S. loans; (2) implementation of debt/equity swaps with debtor nations; and (3) privatization of state-owned enterprises in developing countries.

Securitization of Debt

The first necessary step in allowing the free market to get the world out of the debt trap is to prevent reckless bankers, who are far more concerned about their corporate reputation than the integrity of the U.S. financial system, from continually "restructuring" outstanding, unrecoverable loans. In short, banks need to take their losses for what they are.

Simply because a country cannot pay back its entire loan does not mean that it cannot pay back a part of it. The task becomes one of establishing how much of the outstanding bank loan is irretrievable. This can be done easily by "securitizing" the loan, or selling it on the open market. In securitizing debt, a bank merely converts part of its loan into bonds backed by outstanding debt. The primary function of this action is to establish a "market price for the debt." Securitization allows the market to facilitate bank actions such as Citibank's that determine the present value (in real dollars) of problem loans to the Third World.

Dollars loaned to different countries have different market values, depending on the specific country's ability to repay. For example, if a bank holds a $2 billion loan to Argentina, it is very unlikely that it will ever get the full $2 billion back. Rather than perpetuating the problem by allowing a banker to make additional loans to Argentina in order to sustain its

ability to make interest payments, the bank can literally sell part of its outstanding debt by issuing bonds. By offering the sale of, for example, 1,000 bonds at $100,000 each (5 per cent of the total loan), the bank can effectively determine the current market value for the loan to Argentina.

If these bonds sell at $50,000 each on the open market, then the market value of each dollar loaned to Argentina is at a 50 per cent discount. Once this has been determined, the bank discounts its entire $2 billion loan on the balance sheet to its market value, $1 billion. The bank has lost $1 billion rather than $2 billion (still no small sum).

Since investors will buy the bonds at a price consistent with the ability of Argentina to repay the loan, the bank now has a loan that *can* be sustained and repaid by Argentina. Even though the bank has lost a considerable amount of money outright, it now holds a loan that can be repaid, rather than one that must continually be "restructured" or hidden by fictional accounting. There are a number of notable benefits to this process of securitizing loans.

First, it decreases (at least marginally) the risk of default by discounting the loan to a value that can be repaid by the debtor nation. Consequently, the total debt exposure of the nation is reduced.

Second, by selling debt bonds, the risks of default are spread among many investors. Investors will not buy debt bonds unless they see some potential for gain, so the transfer of risk is strictly voluntary. The risk of default is currently held nominally and involuntarily by the American taxpayers, in their support of FDIC guarantees. Securitizing a loan transfers those same risks currently financed by taxpayers to those investors willing to take them.

Third, securitization liquifies the assets of the bank's portfolio by creating convertibility on the secondary market. Furthermore, securitization gives the indebted country an opportunity to literally buy back its own debt at a discount.

Fourth, securitization restores "truth in accounting." It allows the banks to determine the real market value of debt, cut their losses outright, and consequently reduce the risk of long-term insolvency.[3]

Debt/Equity Swaps

The second way that the private sector can eliminate the debt crisis concentrates not on lending practices, but on the borrower's ability to repay. Increasing the real rate of growth in a debtor nation means its debt can eventually become sustainable. Part of the problem in the current low growth rate of heavily indebted nations is the phenomenon of capital flight precipitated by low or negative rates of return on investments. When the return on an investment is particularly low in a developing nation, its citizens will invest their capital elsewhere.

For example, a bank in the U.S. makes a loan to the government of Argentina in order to foster development. The Argentine government dispenses the money to the private sector, but because the rate of return is so low, private investors merely place the money in U.S. banks. The result is that the government of Argentina owes money that it cannot repay to American banks, and the Argentine economy has nothing to show for it. The loan money, intended to develop Argentina, is sitting in U.S. banks, out of reach of both the Argentine government and its original U.S. lenders.

Until investment can be made profitable in developing nations, their rates of growth will not improve. Debt-for-equity swaps are an effective means of both facilitating growth and contributing to the reversal of capital flight. Such swaps involve the exchange of foreign debt for local equity and have numerous economic benefits.

The success of Chile in this area helps prove the efficacy of debt/equity swaps. In 1986, the market value of Chilean debt denominated in dollars was approximately 67 per cent of its face value (i.e., it was trading on the secondary loan market at a 33 per cent discount). However, its market value was approximately 92 per cent of its original value when denominated in pesos, since most Chilean investors, unlike U.S. bankers, believed that the debt was sustainable.

Loans must be repaid to U.S. banks in dollars, but local equity is denominated in pesos. Consequently, in 1985 Chile changed some of its foreign exchange regulations to encourage debt/equity swaps so that investors

could take advantage of this opportunity for intermarket arbitrage (the purchase and sale of a security on two different markets for the purpose of capitalizing on price discrepancies between different exchange rates) and thereby improve the Chilean investment climate.

Johns Hopkins University economist Steve H. Hanke states that debt/equity swaps are "aimed at investors who wish to purchase external Chilean debt for the purpose of capitalizing it into investments in Chile."[4] The prospect of converting foreign debt into local equity not only has attracted foreign investment to Chile, but it has stimulated the repatriation of Chilean flight capital. In two years, Chile reduced its debt obligation by four to five per cent. As of November 1987, Chile had converted approximately $1.2 billion in debt into local equity.[5]

Encouraging these swaps will enhance the development of capital markets in indebted countries. By increasing capital flows into an indebted nation, its growth rate will increase, eventually raising the rate of return. Debt/equity swaps are an excellent means of reducing the loan exposure of a debtor nation while also stimulating economic development.[6]

Privatization

A third means of decreasing the developing world's debt obligation is to reduce the size of the public sector in the economy of developing nations so as to stimulate growth and development. The elimination of state-owned enterprises in debtor nations will strengthen their economies by promoting the development of capital markets. Privatization also will decrease public sector expenditures and improve economic efficiency.

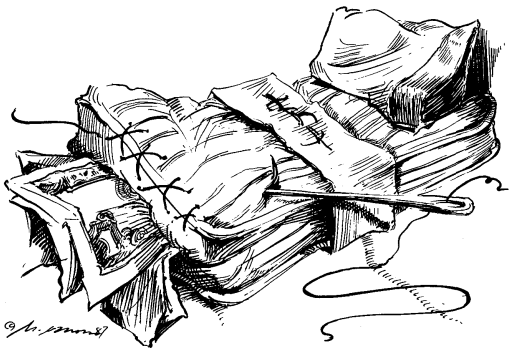
Presently, state-owned enterprises are characterized by insatiable demands for continuing subsidies, bloated payrolls, low employee performance, high costs of debt servicing, and underutilized capital.[7] They typically allocate resources in a very inefficient manner and respond poorly to consumer demands. Transferring state-owned enterprises to the private sector not only will tend to eliminate negative cash flows, but also will stimulate growth by providing opportunities for debt/equity swaps and increasing the economy's productive efficiency.

Privatizing state-owned enterprises also promotes popular capitalism through wider share ownership. Furthermore, it strengthens existing capital markets in developing nations by making such markets more liquid. Indeed, privatizing by open stock sale can actually *create* capital markets where previously there were none. Capital market development promotes economic development because capital market liquidity narrows the gap between what a consumer offers to pay for a good and what a producer charges for it, known as the bid-ask spread. In nations without capital markets, it is often the case that particular goods cannot be sold because bids are so much lower than the prices asked, largely due to informational deficiencies in the economy. Liquid capital markets help alleviate this problem.

Privatization, by promoting a liquid capital market through wider share availability, facilitates economic growth and development. Furthermore, by increasing the role of the private sector and limiting state involvement, an important signal is sent to foreign lenders that efforts are being made to improve real domestic rates of return on investments. In this way, privatization promotes foreign investment and the repatriation of flight capital.

However, obstacles to privatizing state-owned enterprises come in many forms. Privatization is a very complicated process which requires economic liberalization to ensure competition, and the preservation of property rights to mitigate against the threat of expropriation. This is often difficult because of the political instability common in most heavily indebted nations. Many Third World leaders feel that a stronger private sector would jeopardize their political supremacy, and they consequently oppose privatization.

Although most political opposition to privatization is founded on misconceptions, disproving these misconceptions is often very difficult. The U.S. financial sector certainly has not helped matters. Because of its unwillingness to acknowledge *de facto* financial losses already incurred, American banks are allowing the developing world effectively to hold the U.S. financial system hostage. Reckless



lending coupled with irresponsible use of loan money by Third World governments has led to an escalating problem, most of which is purely political: the Third World's unwillingness to compromise or liberalize, and the U.S. financial sector's unwillingness to use its better judgment in lending practices.

As Heritage Foundation's privatization expert Stuart Butler observes, "Privatization, like nationalization, is first and foremost a political exercise."[8] A key step in privatizing state-owned enterprises is simply to convince politicians that privatization works. However, as long as the Third World meets with little or no opposition in its tactics of financial blackmail directed at the banking industry, its leaders have no reason even to bother with liberalization and privatization. To many of them, it is simply a risk that they do not have to take.

Deregulating the U.S. financial sector is a virtual necessity for the long-term elimination of the debt crisis. Banks have irresponsibly overextended their equity and "fixed" their balance sheets primarily because the market does not hold them accountable for their actions. American lending institutions must be made responsible to economic realities. Instituting a system of "mark to market" accounting and regularly evaluating the equity of banks can make them accountable to market risks. Under this system, if a bank becomes insolvent, it *immediately* will be closed, removing the need for the taxpayer-funded insurance system (the FDIC).

Any long-term solution to the debt crisis eventually requires accountability in finance. Securitizing debt enables the banks to determine the real value of their loans and to "cut their losses." Upon cutting their losses, a new system of mark to market accounting will ensure that banks no longer make loans they cannot guarantee. Securitization also allows investors voluntarily to assume part of the banks' risk of loan default, thereby removing the burden from the unconsulted taxpayer.

Through securitization and financial sector deregulation, the banking system of the United States will be held accountable to the market. The long-term solution to the debt crisis then comes from stimulating growth and development within debtor nations. Through debt/equity swaps and the privatization of state-owned enterprises, capital market development is promoted. Then, the real rate of growth can be raised to make Third World debt sustainable.

The debt crisis can be solved. But until U.S. lending institutions decide to confront the crisis it will continue to escalate. Citibank and many others have made steps in the right direction. Indeed, it is true that most banks have markedly improved their loan portolios in the last few years. But the current financial system could easily aggravate existing problems. Until the system is changed, recurrent crises in lending will continue to be an underlying threat. □

1. Sir Alan A. Walters, before "Capital Markets and Development," part of the seminar series "Including the Excluded: Extending the Benefits of Development," sponsored by the Sequoia Institute, Washington, D.C. June 3, 1988.

2. The heavily indebted countries referred to in this data are Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia.

This data comes from the International Monetary Fund, *World Economic Outlook,* April 1987.

3. I am grateful to Sir Alan A. Walters for his insights on securitization. He is, however, blameless for the above views.

4. Steve H. Hanke, "Chilean Flight Capital Takes a Return Trip," *Wall Street Journal,* November 7, 1986.

5. Peter A. Thomas, "Debt Equity Swaps: A Review of an Underutilized Privatization Mechanism" (Washington, D.C.: Center for Privatization, November 1987), p. 3.

6. The positive effects of debt/equity swaps can, however, be lessened by the intervention of non-market forces. With the exception of Chile, all Latin American nations which have engaged in debt/equity swaps to date have witnessed government intervention in the process. Often, the host governments either inform investors which equity investments may be considered for conversion, or they approve each investment on a yes/no basis. In either case, the government has the final say in determining which equity investments are candidates for these swaps.

It should also be noted that, while government intervention in Chilean debt/equity swaps is much less pervasive than in other Latin American nations, the government does play an active role in the process. Internal conversions of debt to equity, for example, have restrictions on the total amount of debt that can be converted by investors, primarily to prevent massive expansion of the money supply.

7. "Why Privatize?" (Center for Privatization: Washington, D.C.), May 15, 1987, p. 6.

8. Stuart Butler, "How to Privatize the Postal Service," before the Cato Institute, April 7, 1988, p. 2.

A REVIEWER'S NOTEBOOK

The American Conservative Movement

by John Chamberlain

Before he was elected to the U.S. Senate, the late John P. East of North Carolina was a professor of political science. A man of great scholarly attainments, he took time out from active politicking to produce a book, *The American Conservative Movement* (Washington, D.C.: Regnery, 279 pp., $18.95), about the seminal thinkers he considered most responsible for the resurgence of the American conservative movement. His choices were seven scholars: Russell Kirk, Richard Weaver, Frank Meyer, Willmoore Kendall, Leo Strauss, Eric Voegelin, and Ludwig von Mises.

In investigating his seven choices, East discovered that they had a most important common religious denominator. They were one with Plato in accepting the certainty of a mysterious creator who was responsible for man as he is, a creature capable of "ascent" but also prone to lapses. Some of the seven were Christians, some preferred to let their belief in a creator stand without reference to Christ and the Incarnation. As for Mises, who wrote purely as an economist, he said his classical liberalism had never pretended to be more than a philosophy of earthly life. Even so, he said "it is not to be denied that the loftiest theme that human thought can set for itself is reflection on ultimate questions . . . the liberals do not disdain the intellectual and spiritual aspirations of man."

Since Senator East's seven thought as one on first principles, there is an inevitable repetition in their biographies. But the surprising thing is that minor differences make for some rather exciting cross currents of argument.

Frank Meyer, for example, who became a Roman Catholic before his death, had bones to pick with Russell Kirk on the subject of Edmund Burke. He conceded that Burke was right in standing against the excesses of the French Revolution. But if Burke had lived at the time of the so-called Glorious Revolution in the Britain of 1688, he would have been wrong to stand on what Meyer calls "the multitudinous wrappings of code and custom."

The New Conservative, said Meyer, "is shaped by such words as 'Authority,' 'order,' 'community,' 'duty,' 'obedience.' 'Freedom' is a rare word; 'the individual' is anathema. The realities of this suggested society are a mixture of those of eighteenth century England and medieval Europe—or perhaps, more aptly, they are those of Plato's Republic with the philosopher-king replaced by the squire and the vicar."

For all his contentiousness, Frank Meyer took it upon himself to hold libertarians, classical liberals, and conservatives old and new together when they went to the polls. East doesn't think Meyer should be called a "fusionist" (he was, at the last, a Christian thinker). But he realized that there were practicalities involved when it came to elections.

Willmoore Kendall was another fractious soul when it came to differing with colleagues on subservient matters. A believer in close textual analysis, Kendall was convinced that John Locke, the instigator of the peaceful 1688 re-

volt against the arbitrary Stuart kings, was a "majoritarian." That was enough to damn Locke in Kendall's eyes. But the American Founding Fathers, who, like Locke, were fighting the presumption of a king to tax as he chose, were not worried by Locke's majoritarian views. They were sure that, with proper exemptions in a Bill of Rights, no majority would ever dare to discriminate against minorities in a way that might deny the "rights of Englishmen."

Leo Strauss of the University of Chicago set innumerable students to thinking about their political institutions. Strauss's concern was for a "spirit" that might be described as "serenity" or "sublime sobriety." He talked of "piety" as the "humble wonder at mystery." The good citizen, in Strauss's view, should dedicate himself to "piety and service."

Tossing the word "service" into the argument must lead to some confusion. The entrepreneur, as Adam Smith insisted, was more often than not a serviceable entity to all of humanity even when he was dominated by selfish aims.

George Nash, who contributes an introduction to Senator East's book, speaks of East's desire to recall American conservatives to their religious roots. Hence the common denominator of picking a religiously motivated six, and a fellow traveler (Mises), for special study. What bothers me about the selection of the seven is that they were not the pioneers of the American conservative movement. I caught up with the seven after an early contact with Henry Hazlitt, Max Eastman, Don Levine, Frank Chodorov, Whittaker Chambers, Leonard Read, Isabel Paterson, Rose Wilder Lane, Ayn Rand, Garet Garrett, Claude Robinson, and Murray Rothbard. The list is long, and could be made longer.

Nash says of East that he would be the first to acknowledge that his seven "were not the only architects of the conservative renascence." East, says Nash, favored his seven because they "did the most to infuse American conservatism with intellectual substance and coherence—who made it, in short, a formidable movement of ideas."

One does not cavil with the statement that Willmoore Kendall, Frank Meyer, and the rest of the seven had "substance" and "coherence." But to imply that Henry Hazlitt, for instance, had less to do with infusing the conservative movement with substance and coherence than Kendall or Meyer is simply to create a one-sided impression. Hazlitt's *Economics in One Lesson,* a perennial best-seller, is certainly full of substance and reads with a beautiful coherence.

I like to give pioneers their special due. I like to recall that Don Levine's *Plain Talk* magazine printed a map of the Russian Gulag long before Solzhenitsyn became a household word. I like to remember the work of William Henry Chamberlin in exposing the man-made famine of 1930 in Stalin's Russia. He certainly changed minds about Communism. American conservatism has had many roots, some of them religious, some not. Even atheists (Max Eastman and Ayn Rand) have contributed to it. □

COGS IN THE WHEEL: THE FORMATION OF SOVIET MAN
by Mikhail Heller

Alfred A. Knopf, Inc., 400 Hahn Road, Westminster, MD 21157
1988 • 293 pp., $22.95 cloth.

Reviewed by Richard M. Ebeling

A sentiment commonly heard in recent discussions concerning future Soviet-American relations is that conflict and tension are inevitable unless these two "great nations" are able to "understand" one another. The presumption is that ignorance breeds fear and war, while knowledge creates a bond of mutual respect and peaceful relationships.

It is certainly true that, even in the new era of *glasnost* in Gorbachev's Russia, the people of the Soviet Union are still limited in the information and ideas they are permitted to receive from the West. In the West, on the other hand, the situation is different. The information available about the Soviet system is vast, but often what gets filtered through the news media is a Soviet Russia seen through rose-colored

glasses: they are really just like us, only different. This is supposed to mean that the Soviets really want the same things we in the West desire—peace, prosperity, justice; it's just that they sometimes use methods that seem a bit brutal by our more sensitive Western standards. If only we could humanize them a little. . . .

Mikhail Heller's recent book, *Cogs in the Wheel: The Formation of Soviet Man,* forcefully argues that an understanding of the Soviet Union requires an appreciation that, from the inception of the Soviet State in 1917, not only the means chosen were different from those in the West, but also the ideological ends for which the power of government has been applied are different. Nationalization of the means of production by Lenin and the Bolsheviks was a tool for a specific purpose: to control all aspects of the social and economic environment so as to create the conditions necessary to make over human nature and produce a new Soviet or Communist Man.

Believing, as good Marxists do, that man is a product of his material environment, the Russian Communists had a vision of a new human being: selfless in character, collectivist in orientation, boundless in his love of labor for the common good, and heroic in his defense of the revolutionary cause. But what Lenin and the Bolsheviks found after the Revolution was a Russian people imbued with the same "bourgeois" traits as everyone else: individuals primarily looking out for number one, more interested in improving the economic conditions of their immediate family, reluctant to work except for incentives and rewards for the labor to be performed, and generally disinterested in making sacrifices for a world revolution.

To achieve their goal, therefore, Professor Heller explains, the Communist Party proceeded to destroy all the cultural and economic institutional structures that surrounded and protected the Russian people. As the author expresses it, the Soviet authorities began a process to "infantilize" every Russian, i.e., to make every Russian completely dependent upon the Soviet State, and, therefore, moldable in a social cast constructed by the Party elite. No corner in the society would be left in which the individual could hide and protect any personal qualities and characteristics undesigned by the State.

In one of the most intriguing chapters, Professor Heller argues that the introduction of the "Five Year Plan" served as an instrument enabling the Party to control the very concept and boundaries of time. All conceptions of temporal horizons, beginnings and endings, goals and intermediary points, were defined in terms of the clock of the plan. The Party could accelerate time (by meeting the plan's goals ahead of schedule), apportion time (by subdividing the plan into weekly, monthly, or yearly production quota periods), and change time (by shortening or lengthening the plan's horizon). By manipulating time and the plans within it, the Party could perform miracles before the eyes of "the masses"; by juggling the numbers and massaging the facts of production, the Party could make it appear as though the laws of nature were subordinate to it.

In the new social order, the individual could have no existence outside of the State—no plans, no identity, no sense of self other than his place as an assigned cog in "the people's" machine.

After explaining the goals and strategies for making the new Soviet Man, Professor Heller methodically describes the techniques: the introduction of fear through an omnipresent and omniscient secret police; the control of labor through internal passports and the State as monopoly employer; the breeding of guilt through corruption, as the black market became a primary avenue for survival; the control of minds through an educational system that intrudes beyond the classroom to the family itself; the planning of culture via Party domination of literature and art; and the manipulation of language and, therefore, thought by a constant bombardment of slogans, phrases, and images that make it difficult to think of words or concepts other than in terms of the meanings bestowed upon them by Party ideology.

In his earlier work, *Utopia in Power* (co-authored with Aleksandr M. Nekrich), Heller exhaustively and impressively traced the history of the Soviet Union. Now, in *Cogs in the Wheel,* he helps complete that picture with a portrait of the cultural and human order Soviet power has produced. Through it, we see that

the Soviets *are not* the same as we are. Those who rule in the Soviet Union have a design different from the Western ideals of a free society. While 70 years of Marxist rule may not have replaced human nature with a new Soviet Man, it *has* influenced the minds of the Russian people. This is seen even in those most recent documentaries on Soviet life in which Western camera crews are approached by ordinary Russians on the street and asked, "Who has permitted this?" What is not explicitly permitted is strictly forbidden. For many Russians, "freedom" only means knowing the difference. And the Party's telling people that they can now have more freedom of expression and action under *glasnost* does not imply that the words will be immediately translated into Western meanings in the minds of the Russian populace. □

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CHANGING COURSE: CIVIL RIGHTS AT THE CROSSROADS

by Clint Bolick

Transaction Books, Rutgers University, New Brunswick, New Jersey 08903 • 1988 • 152 pp., $24.95 cloth.

Reviewed by Carl Helstrom

The civil rights movement in the United States has undergone radical changes in the past 20 years. Following the death of Martin Luther King, the movement deteriorated into a loose-knit faction that claims to advance the ideas of earlier leaders. In reality, the movement has swung full circle to work against the original design.

Clint Bolick, who has served as counsel in several leading civil rights cases, has written a book which could go a long way toward bringing the civil rights movement back on course. The book has two parts. The first contains a brief, yet penetrating, history of civil rights in America. In the second part, Bolick offers his program for re-establishing civil rights based upon the principles of liberty, property, and equality before the law. Throughout the book, Bolick's analysis is incisive and his writing is clear.

Eighteenth- and nineteenth-century civil rights leaders drew heavily upon the ideas of John Locke. Locke wrote that all people have a right to life and property, including property in themselves, and logically deduced the necessity of equal opportunity before the law. He, in effect, set the justification for a free society upon two planes: (1) the ethical notion of the individual's right to property and freedom of choice and (2) the political view of representative government to protect those rights.

This classical liberal concept of equal rights, based upon the right to life and property, made it impossible for slavery to continue unchallenged. The stage was set for the abolition movement.

Organized opposition to slavery in America had begun in the late 1600s, especially in New England and among the Quakers. The Revolutionary leaders documented their support for civil rights in the Declaration of Independence and the Constitution of the United States. Yet they did not eliminate the institution of slavery which was contrary to all they believed and fought to attain.

Bolick details the abolitionists' efforts to eradicate slavery and to educate the public in the classical liberal ideas which form the basis of civil rights. His analysis of this important period in civil rights history is concise and enlightening.

Early nineteenth-century abolitionists promoted several methods of education and manumission with limited success. William Lloyd Garrison became their leader, publishing his arguments in *The Liberator* and participating in the formation of the American Anti-Slavery Society. Regardless of method, the typical abolitionist's stand was upon his or her faith that all persons are created equal. The debate over slavery truly became a battle with lines drawn on moral absolutes.

Resorting to political means, abolitionists founded the Liberty Party in 1839. They met with difficulty because of their limited constituency and voting restrictions on blacks and, in 1848, many joined with the Free Soilers. By 1860, the political forum for the abolitionists

had expanded and strengthened. The result was the Republican Party with Abraham Lincoln as its candidate.

The American Civil War, for all its bloodshed and destruction, ensured that equal rights for all citizens would be incorporated into the law of the land. Slavery was abolished officially in 1865 by the Thirteenth Amendment. Congress also enacted the Freedmen Acts to assist former slaves. The Civil Rights Acts of 1866 and 1871, according to Bolick, held to the original interpretation of civil rights for protection on the Federal and state levels. The Fourteenth Amendment banned discrimination by states; the Fifteenth Amendment ensured voting rights regardless of "race, color, or previous condition of servitude." These Amendments sought to remedy inadequacies in the law and to counter the Black Codes formulated in the South to subjugate the freed slaves after the war.

Stifled on one front, white racists responded by erecting economic barriers to black progress. The Supreme Court sanctioned this approach by taking a narrow view of civil rights in the famous *Slaughter-House Cases*. Various states soon contrived Jim Crow laws modeled after the earlier Black Codes.

The intellectual descendants of the original civil rights leaders were subsequently led by Booker T. Washington. Washington stressed the idea of black self-help, and asked only that the rights of Negroes be construed in the context of equality before the law. His critics, notably W. E. B. DuBois and Marcus Garvey, did not like what they considered his placation of white supremacists. Despite this infighting, the efforts of civil rights leaders succeeded in opening new opportunities for black Americans and culminated in the creation of the National Association for the Advancement of Colored People (N.A.A.C.P.) in 1909, formed expressly to secure equal rights for blacks.

The years of the World Wars and the Great Depression brought new challenges for the civil rights movement. Other minorities entered into civil rights controversies, most notably the Japanese in the 1944 case of *Korematsu* v. *United States,* which supported the incarceration of Japanese-Americans during World War II. This case reaffirmed the "reasonableness" criterion established in 1896 by *Plessy* v. *Ferguson,* which had sanctioned "separate but equal" laws. The states or federal government now could discriminate in the "public interest." In other words, the rights of United States citizens were conditional—determined by the partiality of the legislature and the courts. Legal paternalism was accepted and institutionalized.

The catchword of the twentieth century became "segregation," and two distinctive movements for black civil rights emerged. The traditional ideas were taken up by Martin Luther King and the N.A.A.C.P. Meanwhile, another pressure group developed, picking up some of the old separatist ideas advanced by Marcus Garvey in the last century. Characterized by notions of class conflict, collectivism, and forced economic reallocation, this new separatism was a militant and racist thorn in the side of equal opportunity. Nonetheless, the Civil Rights Act of 1964, the Twenty-fourth Amendment, and the Voting Rights Act of 1965, along with other changes in the 1960s, bolstered the legal and social foundations of civil rights.

Since the 1960s, however, we have witnessed a major alteration in the civil rights movement. Bolick calls the dramatic deviation a "revision" because it borrowed from the old school on the surface, but actually adopted the new separatist approach. The vocal new order calls for equality in result, collective identification, and a questionable perception of "rights" that has little or no relationship to individuals' rights. This is the status of the movement today.

The second part of the book addresses the contemporary civil rights scene and lays out a compelling plan for the future. Particularly noteworthy is Bolick's chapter on "The Necessity of Judicial Action," which contains his theories for returning to the original interpretation of equal rights in the courts. This chapter is especially interesting in light of recent controversies surrounding the Supreme Court that have brought out new questions as to the proper role and impartiality of that court.

On three points, however, I must disagree with the author. First, he advocates "Economic Liberty Acts" to be passed by legislatures on the state and Federal levels. These acts suppos-

edly would promote entrepreneurship by prohibiting government intervention into economic activity. Second, he believes that inner-city areas should be set aside as "enterprise zones," a kind of capsulated capitalism. Third, he endorses a "voucher system" for parents to opt out of public schools and tax credits for supporters of children in private schools. These three suggestions are political remedies subject to the whim and caprice of politicians, and beg the question of truly principled action.

On the whole, however, I cannot speak too highly of this book. If you read between the lines, you realize that what we see and hear today is not the legacy of Dr. King. The loud and intimidating antics of some of today's civil rights leaders may overshadow this fact, but Bolick's message is clear when he concludes that "The challenge is for whites to learn the lessons of the past two decades; for blacks, to demand and exploit the opportunities that America's commitment to civil rights is intended to guarantee; and for all Americans, to be faithful to the ideals upon which this nation's claim to greatness is based." □

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THE FREEMAN
VOLUME 38
JANUARY-DECEMBER 1988

Prepared by
Bettina Bien Greaves

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