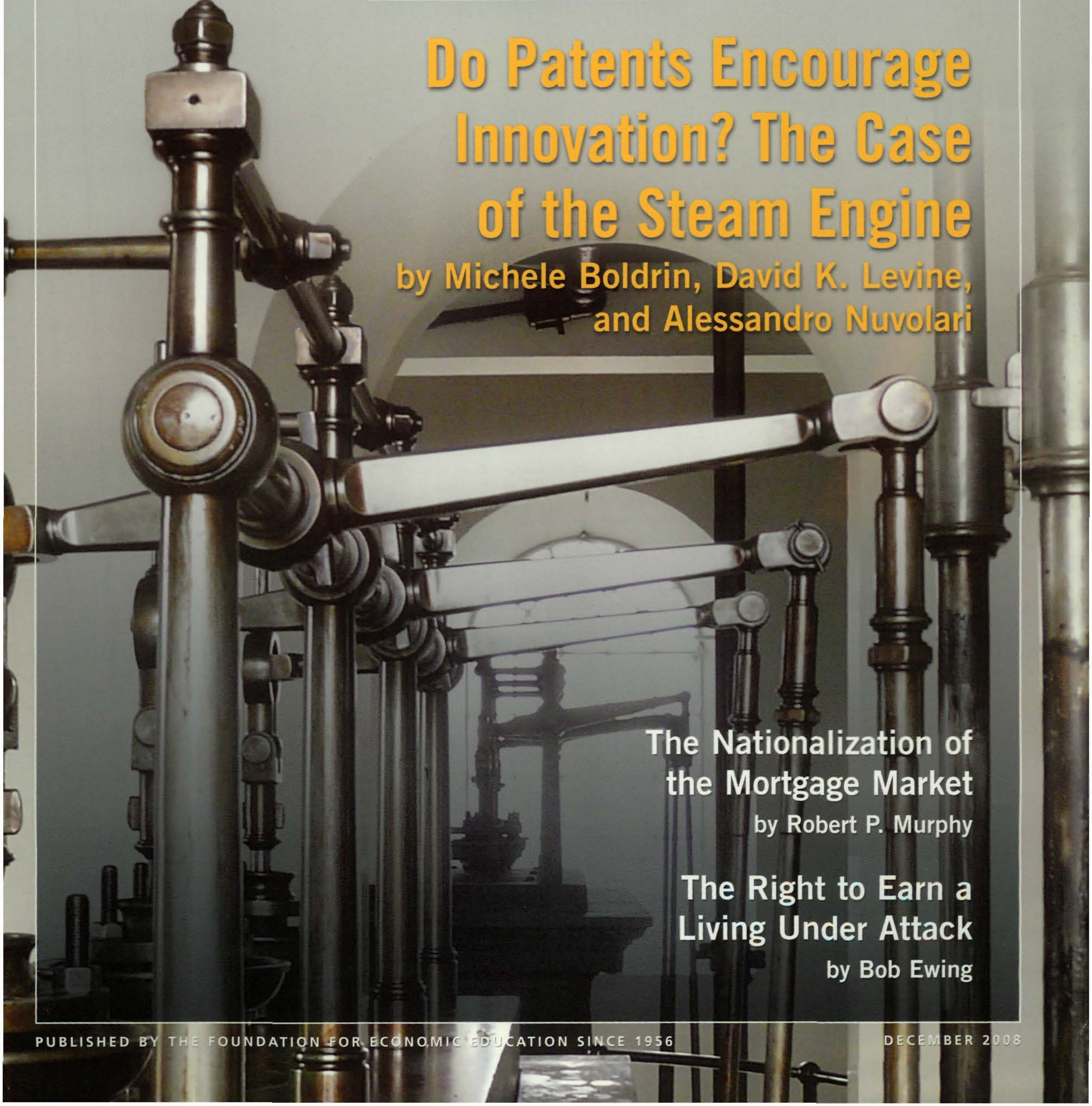
THE FREEMAN

IDEAS ON LIBERTY



Do Patents Encourage Innovation? The Case of the Steam Engine

by Michele Boldrin, David K. Levine, and Alessandro Nuvolari

The Nationalization of the Mortgage Market

by Robert P. Murphy

The Right to Earn a Living Under Attack

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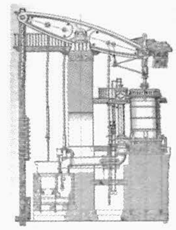

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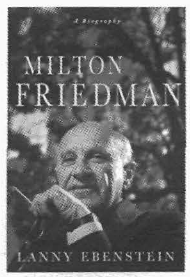

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Cover photo; Chris Revie

Perspective

Bailing Out Statism

The key to understanding the saga of Fannie Mae and Freddie Mac—the newly nationalized twin government-sponsored enterprises (GSEs) that dominate home financing—is this:

They were created—intentionally—to *distort* the housing and mortgage markets. That is, government planners were not content to let voluntary exchange and spontaneous market forces configure those industries unmolested. So—holding the taxpayers hostage—they intervened.

Make no mistake: The collapse of Fannie and Freddie is *government social engineering predictably gone bad.*

In a free society supply and demand would govern markets. The demand for houses would be determined by people's preferences and the wealth and income at their disposal. Supply would be determined by relative profit expectations, which is to say, by the demand for housing and the competing demand for the required inputs.

A distortion occurs when government planners and rent-seeking corporate allies, under cover of humanitarian social policy, engineer a deviation from natural market outcomes. (Rent-seeking here refers to the quest for politically derived as opposed to market-derived profits.) Dressed up as promotion of the American Dream through homeownership, the planners used the political means—ultimately, the threat to imprison uncooperative taxpayers—to channel wealth to the construction, real-estate, and financial industries. The primary instruments of this social engineering were Fannie Mae, created as a government agency during the New Deal and—*cough*—"privatized" in 1968 to get it off-budget, and Freddie Mac, created as a "private" GSE in 1970.

The GSEs don't make mortgage loans. Rather, using borrowed money, they buy mortgages from original lenders, encouraging banks to make more loans and immediately pass them on to others. Pooling lots of mortgages together, the GSEs create mortgage-backed securities (MBS) and either sell them or (more frequently) keep them, assuming the risk of default. In fact Freddie and Fannie created the secondary mortgage market that has come in for criticism since the subprime problem developed.

Freddie's and Fannie's activities were designed to channel money to mortgage lenders so that they could loan widely, especially to people who might have been priced out of a fully private mortgage market. The system inevitably lowered lending standards and interest rates. If these activities had been performed not by GSEs but by real private companies, they would have been subject to market checks. But they were not. *They're not called government-sponsored enterprises for nothing.* As such they have special advantages over real private companies, permitting them to do things on a scale larger than would have occurred in a free market. The advantages include tax exemption, government loans, an implicit bailout promise, and lower capital requirements.

The result was a far more concentrated lending market and hence greater vulnerability to changing conditions. Fan and Fred hold or insure $5.4 trillion in mortgage debt—half the national total—making the taxpayers ultimately responsible now that the GSEs are under federal conservatorship. Three-quarters of new mortgages are GSE-backed. So the government has just become the country's major mortgagee.

The GSEs have lost well over $10 billion since the mortgage meltdown occurred, and they were getting close to being unable to borrow enough money to roll over their debt. This and fear of a more general economic meltdown are what prompted the government to step in, exposing the taxpayers dramatically. The bailout will begin with a billion-dollar infusion. Then the government will start buying shaky Freddie- or Fannie-backed mortgage securities in the marketplace. A $5 billion purchase will get things going, but up to $200 billion has been promised. It will no doubt be more.

Where will this money come from: taxation, borrowing, or the printing press? What will *that* do to our economic well-being?

The *New York Times* is wrong. This is not "an extraordinary federal intervention in private enterprise." *It is the state bailing out statism.* Let's hear no more about the "laissez-faire" Republicans. That myth serves only to protect advocates of state intervention regardless of party.

It is with deep sadness that I note the death in October of our long-time contributing editor Norman Barry after a long illness. Over the years Norman kept Freeman *readers informed about free-market and statist developments in Europe and elsewhere, always with optimism about the future of liberty. He was a professor of social and political theory at the University in Buckingham, which, he proudly noted, is the United Kingdom's only private university. Among his many* Freeman *articles, my favorite is "Freedom and Morality in the Plays of Tom Stoppard" (August 1999, http://tinyurl.com/6h9s5s). He was a gentleman, a prolific scholar, and a pure pleasure to work with.*

★ ★ ★

The consequences and bailout of Freddie Mac and Fannie Mae are big subjects deserving more than a short treatment here. Robert Murphy gives a fuller account inside.

A standard argument for the patent system is that without it innovation would shrivel. But what if it's patents, not their absence, that impede innovation? Michele Boldrin, David Levine, and Alessandro Nuvolari tell the story of the steam engine that couldn't . . . until the patents expired.

The right to earn a living in one's own way is increasingly under assault by special interests successfully lobbying for licensing and other protectionist restrictions. Bob Ewing says people are fighting back.

Centralization of power always threatens liberty. So Pierre Bessard is justifiably nervous about the tax "harmonization" taking place in the European Union.

The poet E.E. Cummings alienated himself from his left-wing friends when he wrote a book in 1931 on how the Soviet Union crushed individuality. Bruce Walker has the details.

Our hard-working columnists have delivered once again. Lawrence Reed teaches the politicians about Adam Smith. Thomas Szasz sees the therapeutic state as an escape from and threat to self-responsibility. Burton Folsom examines the record of Andrew Mellon. John Stossel wonders if we need all those stop signs. Walter Williams picks through fuzzy thinking. And Steven Horwitz, encountering the claim that the free market has failed, replies, "It Just Ain't So!"

Books coming under review this issue are about the welfare state, Milton Friedman, abundance, and three influential economists.

Since it's December, the issue concludes with the year-end index, prepared by Managing Editor Beth Hoffman.

—Sheldon Richman
srichman@fee.org

Mr. President, Meet Mr. Smith

BY LAWRENCE W. REED

As I listened to this year's presidential candidates discuss economic matters, one thought came repeatedly to mind: *Oh, how much they could learn from Adam Smith!* Since it's obviously possible for people to reach the pinnacle of politics without seeming to know much about either economics or Smith, perhaps we're overdue for a little reminder about both.

Smith was baptized on June 5, 1723, in Kirkcaldy, Scotland. It's not known for certain, but it is presumed that he was either born on that very day or a day or two before. Whichever date it was, he entered a world that his reason and eloquence would later transform.

For 300 years before Smith, western Europe was dominated by an economic system known as mercantilism. Though it provided for modest improvements in life and liberty over the feudalism that came before, it was a system rooted in error that stifled enterprise and treated individuals as pawns of the state.

Mercantilist thinkers believed the world's wealth was a fixed pie, giving rise to endless conflict among nations. After all, if you think there's only so much and you want more, you've got to take it from someone else.

The world's first major public monument to Adam Smith, in Edinburgh, Scotland. The statue, unveiled on July 4, 2008, was financed entirely by private contributions.
Courtesy, Adam Smith Institute

Mercantilists were economic nationalists. They thought foreign goods were sufficiently harmful that government policy should promote exports and restrict imports. Exports were to be paid for in gold and silver, not products. To the mercantilist, the precious metals were the very definition of wealth, especially to the extent that they piled up in the coffers of the monarch.

Because they had little sympathy for self-interest, the profit motive, and the operation of prices, mercantilists wanted governments to bestow monopoly privileges on a favored few. In Britain the king even granted a protected monopoly—to a particular, highly placed noble—over the production of playing cards.

Economics in the late eighteenth century was not yet a focused subject of its own, but rather a poorly organized compartment of what was known as "moral philosophy." Smith's first book, *The Theory of Moral Sentiments*, was published in 1759, when he held the chair of moral philosophy at Glasgow University. He was the first moral philosopher to recognize that the business of enterprise—and all the motives and actions in the marketplace that give rise to it—was deserving of careful, full-time study as a modern discipline of social science. The culmination of his thoughts in this regard came in 1776. As American colonists were declaring their independence from Britain, Smith was publishing his own shot heard round the world, *An Inquiry into the Nature and Causes of the Wealth of Nations*, better known ever since as simply *The Wealth of Nations*.

Smith's choice of the longer title is revealing in itself. Note that he didn't set out to explore the nature and causes of the *poverty* of nations. Poverty, in his mind, was what happened when nothing happens, when people are idle by choice or force, or when production is prevented or destroyed. He wanted to know what brings the things we call material wealth into being and why. It was a searching examination that would make him a withering critic of the mercantilist order.

Lawrence Reed (lreed@fee.org) is the president of FEE.

Wealth was not gold and silver in Smith's view. Precious metals, though reliable as media of exchange and for their own industrial uses, were no more than claims against the real thing. All of the gold and silver in the world would leave one starving and freezing if they couldn't be exchanged for food and clothing. Wealth to the world's first economist was plainly this: *goods and services*. Whatever increased the supply and quality of goods and services, lowered their price, or enhanced their value made for greater wealth and higher standards of living. The "pie" of national wealth isn't fixed; you can bake a bigger one by producing more.

Baking that bigger pie, Smith showed, results from investments in capital and the division of labor. His famous example of the specialized tasks in a pin factory demonstrated how the division of labor works to produce far more than if each of us acted in isolation to produce everything himself. It was a principle that Smith showed works for nations precisely because it works for the individuals who make them up. He was consequently an economic *internationalist*, one who believes in the widest possible cooperation between peoples irrespective of political boundaries. He was, in short, a consummate free trader at a time when trade was hampered by an endless roster of counterproductive tariffs, quotas, and prohibitions.

Exploding an Old Fallacy

Smith wasn't hung up on the old mercantilist fallacy that more goods should be exported than imported. He exploded this "balance of trade" fallacy by arguing that since goods and services constituted a nation's wealth, it made no sense for government to make sure that more left the country than came in.

Self-interest, frowned on for ages as acquisitive, antisocial behavior, was celebrated by Smith as an indispensable spur to economic progress. "It is not from the benevolence of the butcher, the brewer, or the baker, that we can expect our dinner," he wrote, "but from their regard to their own interest." Moreover, self-interest was an unsurpassed incentive: "The natural effort of every individual to better his own condition . . . is so powerful, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations."

In a free economy, he reasoned, no one can put a crown on his head and command that others provide him with goods. To satisfy his own desires, he must produce what others want at a price they can afford. Prices send signals to producers so that they will know what to make more of and less of. It wasn't necessary for the king to assign tasks and bestow monopolies. Prices and profit would act as an "invisible hand" with far more efficiency than any monarch or parliament. Competition would improve quality and reduce prices.

Smith displayed an understanding of government that eclipses that of many citizens today when he wrote, "It is the highest impertinence and presumption, therefore, in kings and ministers, to pretend to watch over the economy of private people, and to restrain their expense . . . . They are themselves always, and without any exception, the greatest spendthrifts in the society. Let them look well after their own expense, and they may safely trust private people with theirs. If their own extravagance does not ruin the state, that of their subjects never will."

The ideas of Adam Smith exerted enormous influence before he died in 1790 and especially in the nineteenth century. America's founders were greatly affected by his insights. *The Wealth of Nations* became required reading among men and women of ideas the world over. A tribute to him more than any other individual, the world in 1900 was much freer and more prosperous than anyone imagined in 1776.

Ideas really do matter. America's new president should take time to get acquainted with Adam Smith.

Postscript: In a recent essay in the *New York Times Sunday Book Review*, *Newsweek* editor Jon Meacham revealed that when he e-mailed Barack Obama about the books that have most influenced him, Obama included *The Wealth of Nations* and *The Theory of Moral Sentiments* on his list. The country would benefit if the president-elect would give them a second read before January 20.

FEE

The Free Market Is Failing? It Just Ain't So!

BY STEVEN HORWITZ

There is no doubt the U.S. economy has hit a rough patch over the last several months. As is often the case when economic problems make headlines, pundits rush to declare that capitalism is "in trouble," or "is ailing" or even "has failed." This reaction to economic bad news is as old as capitalism itself. It is also consistently wrong. What the pundits fail to realize is that economic problems, from the recent housing and credit crisis to things like the Great Depression, are far more often, if not always, the result of attempts to intervene into the free market rather than failures of capitalism itself.

An excellent example of this tunnel-vision punditry is E.J. Dionne Jr.'s *New York Times* column of July 11. Dionne argues that a variety of problems facing the economy in 2008 has led to "the collapse of assumptions that have dominated our economic debate for three decades." The assumptions he refers to are that "Regulation is the problem and deregulation is the solution. The distribution of income and wealth doesn't matter . . . [and] free trade produces well-distributed economic growth," among others. In Dionne's view, these ideas are "failing" and "even conservatives recognize that capitalism is ailing."

> Economic problems, from the recent housing crisis to things like the Great Depression, are far more often, if not always, the result of attempts to intervene into the free market rather than failures of capitalism itself.

Unfortunately for Dionne, it just ain't so.

Dionne spends much of the column arguing that the current housing crisis and its spillover effects on the financial industry are the result of, in Rep. Barney Frank's words, "excessive deregulation." There has been some deregulation of the financial markets in the last couple of decades, and much of that deregulation has actually produced incredible benefits for the American public. Aside from the customer-service gains that have come from the legalization of interstate banking and the ability of banks to offer an array of products under one roof, the expanded range of investments that banks can take on enables them to diversify and lower their exposure to risk.

Yes, a number of banks have had problems in the last year (more below), but the number of bank failures since the 1999 deregulation has been exceptionally low. Between 1999 and 2007 only 40 U.S. banks failed, which is substantially lower than the same nine-year periods starting in 1969, 1979, and 1989. Only two years since 1934 have had no bank failures: 2005 and 2006. If the 1999 overturning of the Depression-era Glass-Steagall regulations is such a problem, why were the eight years to follow among the healthiest in U.S. banking history? Assuming deregulation did not have a built-in time delay, this year's banking problems must have some other source.

Those problems are almost all linked to the troubles in the housing market. Here too, blaming deregulation

Steven Horwitz (sghorwitz@stlawu.edu) is the Charles A. Dana Professor of Economics at St. Lawrence University.

is at odds with some important facts. True, financial firms have developed many new tools during the last 25 years. Some of those, such as the adjustable-rate mortgages at the center of the difficulties, were necessitated by previous government intervention in markets—in this case, the Fed-generated inflation of the 1960s and '70s.

More important, though, is the role played by institutions such as Freddie Mac and Fannie Mae, both of which are not the products of laissez-faire capitalism or any sort of "deregulation." Those government-sponsored enterprises have artificially supported elements of the housing market that might not have been economically justified. Other government regulations, such as the Community Reinvestment Act, which requires that banks make a certain proportion of loans to low-income customers in their communities, have forced banks to take on excessively risky investments in housing. Finally, meddling politicians can cause banks to fail by spreading unwarranted concern about their balance sheets, as some have argued Senator Charles Schumer did in the case of the now-failed IndyMac Bank.

In sum, nothing in the current housing and banking troubles indicates some sort of systematic failure of capitalism that can be laid at the feet of deregulation.

Problematic Claim

Dionne also makes a passing comment about the way in which "The Great Depression discredited the radical laissez-faire doctrines of the Coolidge era." This claim is problematic in three ways. First, the 1920s were hardly "laissez-faire," especially in the financial markets. The United States had a government-run central bank along with a host of banking regulations, not to mention all the other economic regulations born out of the Progressive Era and World War I. Second, the Great Depression itself resulted not from the failures of capitalism, but the Fed's monetary mismanagement in the 1920s and 1930s, and its length and depth were caused by the protectionism and interventionism of the Hoover and Roosevelt administrations. The New Deal and World War II did not get us out of trouble; only the explosive growth generated by the freer postwar economy did so. Third, many of the very regulations that emerged from the Great Depression, such as federal deposit insurance, enabled banks to do exactly what Dionne wrongly blames on the market: profiting when they lent well, but shifting losses to others when they messed up.

Finally, Dionne's claim, echoed by Frank, that free trade and capitalism more generally have benefited the wealthy at the expense of the poor also does not hold up to scrutiny. Frank's concern for the "most vulnerable people in the country" is admirable, but free trade, by making cheaper imports available to lower-income Americans and by creating jobs in export industries, has done more for "the most vulnerable" than any government program.

It is also ironic that a man of the left would focus only on the vulnerable in the United States and ignore the massive increase in well-being that free trade has produced for the most vulnerable people *in the rest of the world*. The billions of Chinese and Indians who have risen out of abject poverty in the last decade or so are a major accomplishment of free trade, and that increase in wealth has benefited American citizens as well. The living standards of poor Americans today, measured by what they are capable of consuming, exceeds that of the average American 35 years ago. If free trade is so awful for the poor, Dionne and Frank need to explain how an era of expanding free trade has also produced these increases in the well-being of poor Americans and billions of others across the world whom they seem to think do not matter.

Once again, the pundits grab onto any bit of bad news to declare the death of capitalism, all the while ignoring the ways in which our larger-than-ever government has intervened in the market, producing the very problems they try to blame on the free market. Their misguided analysis is matched only by their continued promulgation of the idea that American living standards are declining, despite abundant data to the contrary. Even with all the government intervention, the (hampered) market continues to improve the lives of everyone, especially the poor. Imagine if the politicians and pundits stopped trying to prevent it from doing so. FEE

The Nationalization of the Mortgage Market

BY ROBERT P. MURPHY

On Sunday, September 7, the United States government took control of more than half the U.S. mortgage market, through its seizure—and that is the word used in mainstream press accounts—of Fannie Mae and Freddie Mac, two colossal government-sponsored enterprises (GSEs), hybrid organizations owned by private individuals yet created by the government. The likes of this and other recent actions taken by Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke have not been seen since the 1930s. Will the GSE takeover someday be viewed as a decisive step in bringing state socialism to the United States?

What is especially noteworthy is the process through which the American public has been desensitized to the explicit expansion of state power in eight short years. It is a virtue that humans adapt quickly to new environments, but this strength can be turned into a weakness by clever politicians.

The housing boom and bust was a product of interventionist monetary policy, namely Alan Greenspan's decision to slash interest rates after the dot-com crash. The crash in real-estate prices has in turn led to large defaults on mortgage payments, inflicting billions in losses for investment banks and other large institutions that had bet heavily on mortgage-backed assets. The heavily regulated financial sector was vulnerable to these unexpected events. What should have been a large hit to real estate and a few institutional investors has now spread and is currently threatening the global financial system itself. (We should keep this episode in mind whenever someone claims that the free market is too unstable and requires wise government oversight to promote stability.)

What should have been a large hit to real estate and a few institutional investors has now spread and is currently threatening the global financial system itself.

Villains and Saints

A panicked citizenry looks about for villains and saints, and the government is only too happy to dispense the labels. The villains are predatory lenders, short-selling speculators, and "do nothing" officeholders and regulators allegedly blinded by their laissez-faire faith, while the heroes (naturally) are the populist politicians who promise to clean up the greed and irresponsibility of the nefarious financial industry. If citizens would just suspend their abstract aversion to nationalization of large sectors of the economy, the government could keep them safe from further economic harm.

The Federal National Mortgage Association—FNMA or Fannie Mae—was founded as an agency of the federal government as part of the New Deal in 1938. Its function was to create a secondary market for mortgages, meaning that Fannie Mae, rather than originating loans to homebuyers, would buy mortgages (and their expected payment streams) from community banks and thrifts. In 1968 Fannie Mae was transformed into a private-sector company with shareholders, and its official connection with the gov-

Robert Murphy (rpm@consultingbyrpm.com) is the author of The Politically Incorrect Guide to Capitalism.

ernment was transferred to the Government National Mortgage Association (GNMA or Ginnie Mae). The Federal Home Loan Mortgage Corporation (Freddie Mac) was chartered in 1970 as another government-sponsored enterprise in the secondary mortgage market; it too is owned by shareholders.

The ostensible purpose of Fannie and Freddie is to promote homeownership. The two GSEs buy mortgages and bundle them into mortgage-backed securities, which are sophisticated derivatives that slice and dice the incoming monthly mortgage payments such that outside investors can (in theory) limit the risk of their real-estate investments. By providing a huge and liquid secondary market for mortgages, Fannie and Freddie make it more lucrative for others to originate mortgages. Make no mistake about it: The official mission of Fannie and Freddie is to cause banks to lend to applicants who would be rejected in the absence of government meddling. This point needs to be stressed as analysts wonder, "Why did banks make so many bad loans?"

All of this raises an obvious question. How exactly do Fannie and Freddie achieve their goal of promoting more mortgage origination than would have occurred in a free market? The answer is that these GSEs enjoyed implicit—and now explicit—government backing. Until quite recently, the official position of the federal government has been that Fannie and Freddie were private companies, earning private profits to be distributed to private shareholders. No taxpayer money stood behind them. However, investors suspected the GSEs were too big and too symbolic to be allowed to fail. Consequently, investors were willing to lend money to Fannie and Freddie—by buying bonds issued by these two GSEs—at lower interest rates than these same investors would have charged a truly private firm that performed Fannie's and Freddie's operations. Because their bonds were presumably guaranteed by the "full faith and credit" of the U.S. government—meaning the IRS and printing press—Fannie and Freddie were able to gain a huge share of their market; they directly owned or guaranteed roughly $6 trillion in mortgages. To repeat an earlier observation: The vulnerability of the overall system to a few giant firms is itself a product of intervention in these markets. If the government suddenly promised that it would use tax dollars to make creditors whole if Apple defaulted on its bonds, then we would expect it to become more "profitable," cut prices, and gain market share from Microsoft.

> The vulnerability of the overall system to a few giant firms is itself a product of intervention in these markets.

It is worth pointing out that plenty of insiders got rich during the good times. Former Fannie chairman Franklin Raines earned some $90 million in compensation from 1998 to 2003. Even during the "bad times," things weren't so tough for the people running the two politically connected firms. As part of its takeover, the government ousted CEOs Daniel Mudd (Fannie) and Richard Syron (Freddie), yet they are entitled to compensation packages that could be worth up to a combined $24 million.

A Culture of Recklessness

Besides the implicit backing of their debt, the GSEs also enjoyed less regulation than their purely private counterparts. This bred a culture of recklessness and short-term thinking. To hit targets and trigger bonus payments to top executives, Fannie Mae manipulated its earnings over the period 1998–2004. Yet even when it was "caught," Fannie was only fined $400 million in what was an $11 billion accounting scandal. Furthermore, one suspects that the full $400 million penalty did not fall entirely on the executives who defrauded their own investors, meaning the gamble was well worth it from their narrow point of view. Students of political economy know that regardless of the official motivation for a new government agency or program, once it is up and running, politicians, bureaucrats, and corrupt businesspeople will find ways to enrich themselves at taxpayer expense.

What is particularly insidious about government debt guarantees and rescue loans—whether the implicit backing given to Fannie and Freddie for decades or the explicit guarantee given to the Mexican government during its own credit crisis in 1995—is that they can often seem costless. Indeed, the U.S. Treasury actually made money on its "bailout" of Mexico because the Mexican government didn't default on the bonds it had sold to investors around the world. In similar fashion, it didn't cost the government anything for its implicit protection of the GSEs when housing prices were booming in the mid-2000s.

All of this changed, however, once house prices began sharply falling. Speculative buyers and those who had planned to refinance out of ARMs were now caught with mortgage payments they couldn't afford, and so they began walking away. The stream of monthly payments into the bundled securities created by Fannie and Freddie was now drying up, and so the giants began losing money because as part of their normal operations they had guaranteed some of these payments. From the fourth quarter of 2007 through the second quarter of 2008, the two reported combined losses of $11.7 billion. *Now* the cost of the government's backing would be evident.

When Paulson talks of "supporting the availability of mortgage finance," this means making mortgages more available than they would be in a purely free market.

Parsing Paulson

It will be instructive to parse the actual announcement of the Fannie and Freddie seizure. Right out of the chute, Paulson explained:

> In July, Congress granted the Treasury, the Federal Reserve and FHFA new authorities with respect to the GSEs, Fannie Mae and Freddie Mac. Since that time, we have closely monitored financial market and business conditions and have analyzed in great detail the current financial condition of the GSEs—including the ability of the GSEs to weather a variety of market conditions going forward. As a result of this work, we have determined that it is necessary to take action.

Note that the Congress didn't send a bill to President Bush asking to nationalize the two corporations. On the contrary, it merely gave the relevant agencies the legal permission to take such actions if deemed "necessary." This latter strategy is far harder to contain, because who could possibly object to giving the executive branch options? That seems to be a different issue from the question of which options were good ones. Thus members of Congress can truthfully say that they merely voted in the interest of *preparedness* for a takeover. The president and his minions can take the blame or praise for the specific exercise of the powers so delegated.

Paulson went on to say:

> Since this difficult period for the GSEs began, I have clearly stated three critical objectives: providing stability to financial markets, supporting the availability of mortgage finance, and protecting taxpayers—both by minimizing the near-term costs to the taxpayer and by setting policymakers on a course to resolve the systemic risk created by the inherent conflict in the GSE structure.

The problem here is that the "critical objectives" are incompatible. When Paulson talks of "supporting the availability of mortgage finance," this means making mortgages more available than they would be in a purely free market. To achieve that objective, then, the government must expose taxpayers, and the skewed incentives will necessarily distort the financial markets. Again, there is no way around this. If the government induces lenders to make loans that they originally thought were too risky, then the government has obviously made the overall system *more* volatile.

After Paulson's opening remarks, he turned the podium over to James Lockhart, director of the new regulator, the Federal Housing Finance Agency. Lockhart explained that the GSE structure was inherently flawed because private shareholders pocketed gains while the taxpayers were ultimately on the hook for massive losses. Even so, Lockhart further explained that as part of the takeover, Fannie and Freddie would expand their portfolios of mortgage-backed securities before reducing them steadily starting in 2010. As usual with government, when something isn't working, the solution is to make the problem grow—call it a "surge" in mortgage portfolios. No doubt future administrations will continually revisit whether conditions "on the ground" warrant a reduction in the monstrous agencies.

Lockhart also revealed that in exchange for its guarantee, the Treasury received senior preferred equity shares and warrants (similar to call options) that entitle the Treasury to purchase up to 79.9 percent of the common stock of the two companies under certain conditions. (To the best of my knowledge, those "certain conditions" were not revealed to the public—it's not merely that reporters have omitted the precise details out of laziness.)

It is significant to point out that the preferred and arguably even the common shareholders were robbed in this procedure. The Treasury's "senior preferred equity shares" bump the original preferred shareholders down a peg, forcing them to absorb losses before the Treasury takes a hit. On the other hand, if things turn around and Fannie and Freddie stocks recover, then the Treasury would find it profitable to exercise its warrants and thereby dilute the values of the other shareholders. For these reasons, the term *seizure* is far more accurate than *rescue* to describe the government's actions with respect to Fannie and Freddie.

The government cannot create wealth.

The government cannot create wealth. Although he is very smart and understands financial markets, Henry Paulson cannot centrally plan the mortgage market to improve on the spontaneous outcome of voluntary interactions among millions of professionals in the private sector. The fundamental causes of our current financial crisis were mortgages granted to unqualified applicants, as well as investors making very risky bets on assets derived from these mortgages. The bailout of those who lent to Freddie and Fannie, and the easing of the GSEs' regulatory limits, will only sow the seeds for a potentially worse crisis down the road.

The Trend Toward State Socialism

Beyond the harmful effects on the real-estate and mortgage markets, the seizures of Fannie and Freddie—as well as the bailout of AIG the following week—reinforce the trend toward outright state socialism. Investors are looking less at fundamentals and more at government announcements. The idea that these moves are encouraging "stability" is ludicrous, as the once-mighty Lehman Brothers was allowed to fail in between the two massive bailouts.

During normal economic times, if the government began seizing firms and disbursing hundreds of billions of dollars to particular institutions, and furthermore if each action were discretionary and impossible to predict even one week in advance, then everyone would recognize these policies as incredibly destabilizing. Yet this destabilizing effect still exists when laid over a backdrop of massive losses, and in fact hurts even more because of the victim's initial weakness.

Hard as it is to believe, the best course of action would have been for the government to allow these troubled firms to fail. This would be akin to pulling the Band-Aid off quickly, which is temporarily painful but soon forgotten. But with the possibility of federal bailouts and other novel techniques to revive the housing sector, troubled firms have been postponing the inevitable, hoping for a reversal of misfortune. As the financial crisis has now entered its second year, Bernanke and Paulson are pulling off the Band-Aid very slowly indeed.

As government-sponsored entities, Fannie Mae and Freddie Mac allowed their private executives to profit greatly from implicit taxpayer support over a period of decades. However, now that their excessive risk-taking has finally caught up with them, the GSEs' shaky balance sheets have been absorbed by the federal government, which at the same time has announced that the two failing giants will take on even more obligations. Besides the further bilking of the taxpayer, the seizure is an ominous sign of just how much power the executive branch has accumulated. The takeover of Fannie and Freddie will do nothing to promote stability in the financial markets in the long run, but it will serve as a precedent for further "necessary" expansions of government control of the economy. FEE

The Burden of Responsibility

BY THOMAS SZASZ

Life is an unending series of choices and, therefore, "problems in living." Ordinary choices—what to have for breakfast—we ignore as trivial. Extraordinary choices—whether to kill ourselves (or worse)—we dismiss as the symptoms of mental illness. The profession of psychiatry rests on, and caters to, the ubiquitous human desire to avoid, evade, and deny the very possibility of morally "unthinkable" choices. We use the rhetoric of psychiatry to transform such choices into medical-technical problems and "solve" them by appropriate "medical treatments." This is why deception and prevarication are intrinsic to the principles of psychiatry, and fraud and force are intrinsic to its practices.

We humans are choice-making animals. The freedom to make choices is both a blessing and a curse. Depending on age, temperament, information, and alternatives, some people experience the opportunity for choice as exhilarating, others as tormenting. Traditionally, it was one of the functions of religion to relieve people of choices. Today, psychiatry and the therapeutic state perform the same job.

We humans are choice-making animals. The freedom to make choices is both a blessing and a curse.

Karl Jaspers (1883–1969)—the great twentieth-century German psychiatrist-turned-philosopher—understood this. But he identified only one part of this drama, the patient's: "Generally formulated, we may say that these people ["neurotics"] are determined that events for which they are accountable and in which they are understandably concerned shall be taken as mere happenings, for which they are entirely irresponsible." Psychiatrists were, and are, happy to play the other part, authenticating the person's false self-definition as mental patient—medical object, not moral actor.

Lord Acton

There is important religious precedent for the authoritative declaration of falsehood as truth. In 1870, under the leadership of the legendary Pope Pius IX—Pio Nono, the longest-reigning and one of the most colorful popes in history—the Vatican declared the dogma of papal infallibility. This was anathema to Lord Acton (1834–1902), the most respected Catholic layman in Europe in his time. Alienated from the Church, Acton did not leave it; and, probably because he had not been ordained, he was not excommunicated. It was in the context of this moral conflict that, in 1887, in a letter to Bishop Mandell Creighton, Acton made his famous pronouncement:

"I cannot accept your canon that we are to judge Pope and King unlike other men, with a favorable presumption that they did no wrong. If there is any presumption it is the other way against the holders of power, increasing as the power increases. Historic responsibility has to make up for want of legal responsibility. Power tends to corrupt and absolute power corrupts absolutely."

Most people who quote Lord Acton's famous dictum today are unaware it refers to papal power and was made by a devout Catholic. In 1882 Acton, now alienated from his great teacher and lifelong friend, Father Johann Ignaz von Döllinger, who was excommunicated for opposing the infallibility doctrine, writes him:

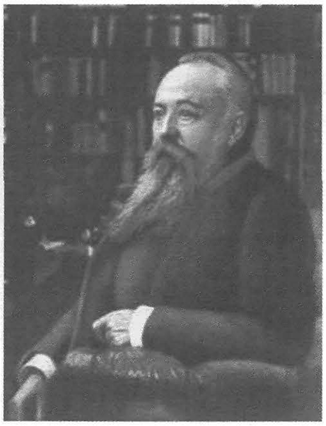
"I came, very slowly and reluctantly indeed to the conclusion that they [the great Catholic notabilities] were dishonest. And I found out a special reason for

Thomas Szasz (tszasz@aol.com) is professor of psychiatry emeritus at SUNY Upstate Medical University in Syracuse. His latest books, both from Syracuse University Press, are The Medicalization of Everyday Life: Selected Essays *and* Psychiatry: The Science of Lies.

their dishonesty in the desire to keep up the credit of authority in the Church. . . . When I got to understand history from the sources, especially from unpublished sources, the reason of all this became obvious. There was a conspiracy to deceive. . . . That men might believe the Pope it was resolved to make them believe that vice is virtue and falsehood truth."

Acton regarded the claim of papal infallibility as evidence of intolerable religious arrogance and power. I regard psychiatric infallibility—the unfalsifiability and irrefutability of psychiatric diagnoses backed by mental-health laws—as evidence of intolerable psychiatric arrogance and power.

Acton thought "he witnessed the triumph of error in history." Indeed, he had. Today, we witness a similar—but more ominous—triumph of error in medicine-psychiatry. In addition to persuading the public and the government that human problems are medical diseases, psychiatrists have succeeded in abolishing the concepts of responsibility, guilt, and innocence, and in replacing punishment with the irrefutable and ineradicable stigmata of psychiatric "diagnoses" and "treatments." "Modern psychiatry," I wrote in 1970, "dehumanize[s] man by denying . . . the existence, or even the possibility, of personal responsibility, central to the concept of man as moral agent." It accomplishes that evil by treating responsibility, following Ambrose Bierce, as "a detachable burden easily shifted to the shoulders of God, Fate, Fortune, Luck or one's neighbor." In our day, it is not merely customary but, in matters that really count, mandatory to unload responsibility on Mental Illness ("he snapped," "had a breakdown," "battled his demons," "was on drugs," "went off prescribed medication," and so forth).


Lord Acton

In Acton's day the separation of church and state was an established political practice in many countries. Hence, the Church's moral failures and self-arrogated powers affected only persons who chose to be its adherents. Our predicament is more serious. We live at a time when the alliance of medicine-psychiatry and the state is taken for granted—viewed as an unalterable social fact and undoubted moral and social good. Everyone, regardless of personal choice, is affected, directly or indirectly, by the powers of the therapeutic state.

Psychiatry and the State

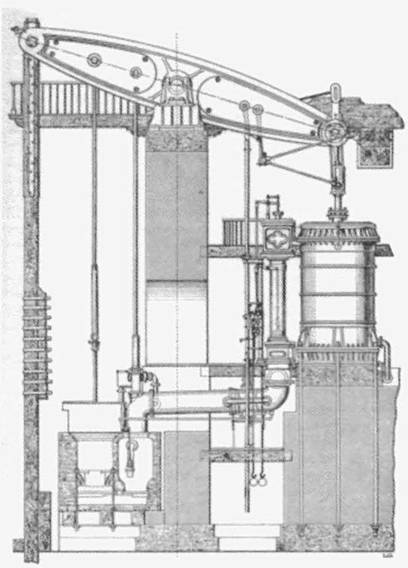
Given its limited legal-political powers, the Vatican could not have tried to purge the world of its critics, much less intimidate them into becoming its crypto-supporters. In contrast, in our day the alliance of psychiatry and the state has enabled pharmacracy to do just that. Its so-called critics—who call themselves "antipsychiatrists," "critical psychiatrists," "ethical psychiatrists," and so on—oppose one or another psychiatric "diagnosis" or "treatment," rarely even psychiatric coercion. But they all support the view that the misbehavior of individuals afflicted with/suffering from so-called mental illnesses ought not be regulated by the same rules as are the misbehaviors of individuals not so denominated: They recoil from defending an ethic based on personal responsibility for public actions (as distinct from private actions, called "thoughts") and of every individual's inalienable right to his or her life and death, lest they appear uncompassionate and, perish the thought, unscientific and illiberal (in the modern, statist sense of "liberal"). Thus they endorse—explicitly or by the assent of silence—psychiatry's war on responsibility, epitomized by the wars on drugs, mental illness, and suicide and by the insanity defense.

"Truth," said Thomas Jefferson, "will do well enough if left to shift for herself. She seldom has received much aid from the power of great men to whom she is rarely known and seldom welcome. She has no need of force to procure entrance into the minds of men. . . . It is error alone which needs the support of government." Jefferson was right in applying this principle to religion: modern states should not (and for the most part do not) lend their coercive powers to the support of the clerical lies of priests. Nor should they lend their coercive powers to the support of the clinical lies of psychiatrists. As long as they do, serious persons ought not to take psychiatry seriously—except as a threat to reason, responsibility, and liberty. FEE

Do Patents Encourage or Hinder Innovation? The Case of the Steam Engine

BY MICHELE BOLDRIN, DAVID K. LEVINE, AND ALESSANDRO NUVOLARI

Many economists are in love with the idea of a natural experiment. A natural experiment is a turn of events that enables a clean comparison between two different economic-policy alternatives. For many economic policies we do not have the good fortune of a natural experiment. In these cases economists must fall back on other less-reliable modes of econometric analysis. Fortunately for other economic policies nature has been kind enough to provide us with the laboratory we need.



A nineteenth-century drawing of a Cornish steam engine

The Patent Controversy

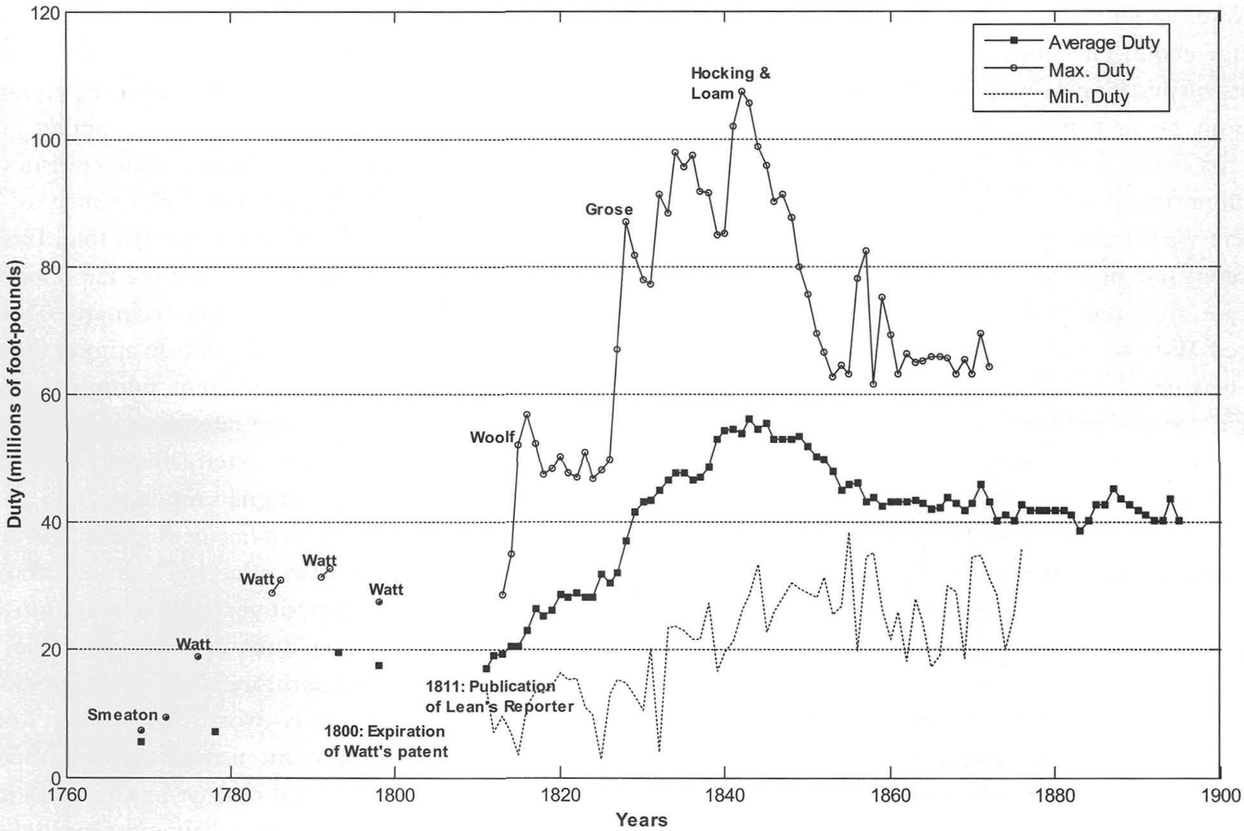
Today one of the most controversial issues in economic policy is that of patent law. Is a patent just an extension of property rights to the realm of ideas? Or is it an unwarranted interference by the government into the rights of individuals who have purchased goods and services to use them as they see fit? Should the Western system of patents be extended worldwide? Or should we get rid of patents entirely? Is the patent system responsible for modern miracle drugs? Or is it to blame for the millions dying of HIV in Africa? Do patents lead to greater innovation and economic growth? Or do they kill the goose that lays the golden egg?

The issue of whether patents are genuine property rights or unwarranted government interference cannot of course easily be answered by a natural experiment. We will leave that discussion to philosophers. The impact of patents on innovation does have an objective answer. In this case history instead of nature has been kind enough to provide us with a wonderful natural experiment. This experiment took place in the county of Cornwall, England, between 1772 and 1852. It was there, in the extreme southwest of England, in the wet depths of the Cornish copper and tin mines, far removed from the supply of coal in Wales, that the steam engine was pioneered.

To examine innovation in steam technology, we need a measure of how good a steam engine is. One important measure is the amount of work delivered by a given amount of fuel. This can be measured by the *duty* of a steam engine: the number of pounds of water that can be lifted one foot for each 94 pounds of coal consumed.

In 1772 steam engines were of the so-called Newcomen design of which the best had a duty of 10 million foot-pounds (10M). In 1777 Matthew Boulton and James Watt began selling the first steam engines with a separate condenser. These initially had a duty of 18M, rising

Michele Boldrin (micheleboldrin@gmail.com) and David Levine (david@dklevine.com) are professors of economics at Washington University in St. Louis. Boldrin is co-editor of the Review of Economic Dynamics. *Levine is president of the Society of Economic Dynamics. Alessandro Nuvolari (A.Nuvolari@tm.tue.nl) is an assistant professor of the economics of science and technology at Eindhoven University of Technology in the Netherlands.*



by 1792 to a peak of 26M. There things rested until 1814 when the use of the high-pressure design of Richard Trevithick led to engines with a duty of 55M. The duty then rose relatively continuously until it reached a peak of 110M in 1852.

To summarize: During the 42 years from 1772 to 1813 duty rose 3.8 percent per year; during the 38 years from 1814 to 1852 duty rose more than twice as fast—8.5 percent per year. The evolution of the duty is charted in the figure. The state of innovation is best represented by the best engine currently being produced, but for completeness the average and minimum duty of constructed engines is reported. The decline in duty growth after 1852 reflects both the general decline of the Cornish mining industry and the more difficult conditions in which steam engines were forced to operate due to the deepening of the mines.

As it happens there is one critical difference between the earlier period and the later period. By patenting the separate condenser Boulton and Watt, from 1769 to 1800, had almost absolute control on the development of the steam engine. They were able to use the power of their patent and the legal system to frustrate the efforts of engineers such as Jonathan Hornblower to further improve the fuel efficiency of the steam engine. By way of contrast, and fortunately, Trevithick did not patent his equally innovative high-pressure design.

Ironically, not only did Watt use the patent system as a legal cudgel with which to smash competition, but his own efforts at developing a superior steam engine were hindered by the very same patent system he used to keep competitors at bay. An important limitation of the original Newcomen engine was its inability to deliver a steady rotary motion. The most convenient solution, involving the combined use of the crank and a flywheel, relied on a method patented by James Pickard, which prevented Watt from using it. Watt also made various attempts at efficiently transforming reciprocating into rotary motion, reaching, apparently, the same solution as Pickard. But the existence of a patent forced him to contrive an alternative less-efficient mechanical device, the sun and planet gear. It was only in 1794, after the expiration of Pickard's patent, that Boulton and Watt adopted the economically and technically superior crank. The impact of the expiration of Watt's patents on his empire may come as a surprise as well. Far from being driven out of business, Boulton and Watt for many years were able to charge a premium over the price of other steam engine manufacturers.

Here we see clearly the upside and the downside of the patent system in action. The upside is that it may be the case that the prospect of a 31-year monopoly induced Watt to spend three and a half years of his life—between late 1764, when he first was asked to repair a steam engine, and mid-1768, when he applied for patents on his improved design—working to improve steam technology.

The downsides are two. The first is that the reward to success bears no relation to the cost of invention. In what respect is it necessary, reasonable, or fair to grant a 31-year monopoly and make a man fabulously wealthy because he spent a few years working on a project that benefited his fellow man? Certainly this kind of inducement was not needed for Trevithick, whose contribution to steam technology raised the duty 110 percent as against Watt's contribution, which raised the duty only 80 percent.

The collaborative innovation occurring after the expiration of the Watt patents resembles nothing so much as modern open-source software development.

The second downside of the patent system is the devastating effect it has on incremental innovation. From 1786 to 1800 there was no increase in the duty of steam engines at all, as Boulton and Watt successfully sought to prevent competition by suppressing innovation. This should be a cautionary note for people who think that the current wave of patent litigation triggered by a system of software patents created by the courts is likely to have a beneficial impact on software innovation.

Collaborative Innovation

For the 11 years following the end of the Boulton and Watt monopoly, Cornish mining activities underwent a period of slackness, as the mine adventurers were content with the financial relief coming from the cessation of the premiums they had paid to Bolton and Watt. As a consequence they neglected the maintenance and the improvement of their engines. This situation lasted until 1811, when a group of mine captains decided to begin the publication of a monthly journal reporting the relevant technical characteristics, the operating procedures, and the performance of each engine. Their explicit intention was twofold. First, the publication of the reports permitted the rapid individuation and diffusion of best-practice techniques. Second, it introduced a climate of competition among the engineers entrusted with the different pumping engines, with favorable effects on the rate of technical progress. Joel Lean, a highly respected mine captain, was appointed as the first engine reporter. The journal would later be called *Lean's Engine Reporter.* During the 31 years after 1811 this collaborative competitive effort at innovation raised duty by more than the great "breakthrough" of Watt ever did.

It is worth remarking another important feature of the process of technical change in Cornish engines during the collaborative period. Most engines were single-cylinder, high-pressure, single-acting engines, with a plunger pump of the type originally erected by Trevithick in 1812. Interestingly enough, however, alternative designs were never completely ruled out. For example, in different periods, engineers such as Arthur Woolf and James Sims continued to experiment with compound engines. Throughout this period, the development of the Cornish engine remained a fluid state and this facilitated a more thorough exploration of alternative designs.

The astute reader will no doubt notice that the collaborative innovation occurring after the expiration of the Watt patents resembles nothing so much as modern open-source software development. Like with open-source software, altruism and socialism played no role—just good old-fashioned capitalist incentives. Engineers were recruited by captains of the mine on a one-off basis to build and design an engine. Engineers were in charge of the design and they supervised the erection of the engine that was commissioned to them. They also provided directions for day-to-day working and maintenance of the engines they were entrusted with. Thus the publication of technical information concerning the design and performance of different steam engines permitted the best engineers to consolidate their reputation and improve their career prospects. Over time, this practice gave rise to a professional ethos favoring sharing and publication of previous experiences.

Much of the free/open-source-software industry operates this way today, with software engineers competing for future business through the quality of their current innovations. Sharing of information is a key part of this competition. If Linus Torvalds, creator of the Linux kernel, is not nearly so rich as Bill Gates, he is nevertheless richer than most of us. (See Michele Boldrin and David K. Levine, "Open-Source Software: Who Needs Intellectual Property?" *The Freeman*, January 2007, http://tinyurl.com/6hnyxf.)

Even the modern controversy over the current effort of the Free Software Foundation to limit software patents through the General Public License Version 3 finds reflection in the earlier Cornwall experience. Familiar with the negative impact of the Watt patents on innovation, Cornwall mine engineers were reluctant to patent their inventions. From 1781 to 1852 Cornish residents took out a grand total of 15 patents on steam technology—against 994 patents on steam technology in all of England during that period. Will it surprise you to learn that the area with the fewest patents also was the area that contributed the most to the innovation and development of steam technology?

One may wonder why development in an obscure corner of England should draw our attention. As it happens, the design of fuel-efficient high-pressure steam engines did not only serve to improve the efficiency of pumping water out of mines in one small region. It is the fact that efficient high-pressure engines can be made light and compact and do not require much weight of fuel that made possible such modest advances as . . . the steam train, the steam boat, the steam jenny, and the steam just-about-everything-else. In short—the steam engine that we imagine as the centerpiece of the Industrial Revolution, the key link that took us from riding horses to being frequent fliers—was not the product of the inventive genius of James Watt. When the Boulton and Watt monopoly expired in 1800 steam engines were used only to pump water out of mines. The earth-shattering innovation of widely usable steam engines was the product of the efforts of Joel Lean and dozens of other equally anonymous Cornwall mining captains and engineers. It is equally a tribute to their steady innovation without making use of patents. FEE

The Right to Earn a Living Under Attack

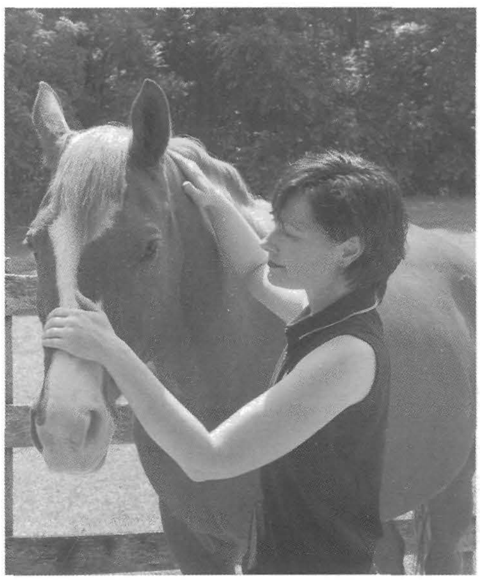
BY BOB EWING

"Laws are like cobwebs which may catch small flies, but let wasps and hornets break through."

—Jonathan Swift, "A Critical Essay upon the Faculties of the Mind," 1709

In Louisiana it is illegal to sell and arrange flowers without permission from the government. Aspiring florists must pass a subjective licensing exam that is graded by existing florists, who have a direct incentive to keep new competitors from entering the market. Thus the failure rate is higher than that of the Louisiana bar, which results in hundreds of well-qualified would-be entrepreneurs being denied the ability to work in their chosen profession.

No one can honestly believe that Louisiana's flower cartel is necessary to protect consumers from renegade flower sellers. Rather, it is a classic case of protecting favored groups at the expense of consumers and entry-level entrepreneurs.



Mercedes Clemens
Courtesy, Institute for Justice

Such is the state of economic liberty in America today. Across the nation, the basic right to earn an honest living is under attack. Legislators and bureaucrats are teaming up with entrenched special interests to create needless obstacles to countless entrepreneurs' pursuit of the American Dream. In the past few decades there has been a nationwide explosion of protectionist regulations—while there were about 80 occupations with such barriers to entry in 1981, today there are over 1,000.

An Institute for Justice (IJ) case that recently attracted international media attention vividly illustrates the uncontrolled growth of occupational licensing and the outrageous lengths that a cartel will go to protect all facets of its business from the most harmless of trades.

Mercedes Clemens was threatened with thousands of dollars in fines and criminal prosecution unless she stopped . . . massaging horses. In Maryland two powerful groups decided to monopolize the growing field of animal massage by requiring all practitioners to spend four years in veterinary school—where massage is not even taught.

Suggesting that only people with veterinary degrees are capable of massaging animals is like suggesting that only people with medical degrees are capable of massaging humans. Preventing Clemens—who is a licensed human-massage therapist and certified in equine massage—from working in her chosen trade has absolutely nothing to do with consumer or animal safety and everything to do with the financial interests of the veterinary cartel.

In 2004 the Tenth U.S. Circuit Court of Appeals wrote in *Powers v. Harris*, "[W]hile baseball may be the

Bob Ewing (bobewing@gmail.com) is the assistant director of communications for the Institute for Justice.

national pastime of the citizenry, dishing out special economic benefits to certain in-state industries remains the favored pastime of state and local governments." And for decades, following the instructions of the U.S. Supreme Court, federal and state courts have stood by while legislators engage in this "favored pastime" at the expense of consumers and entrepreneurs.

Government Protects Special Interests

In the absence of meaningful judicial supervision, politicians have gone to almost any imaginable length to protect special interests. When a powerful lobby demands protection from competitors, governments have been all too willing to invent—and courts all too willing to accept—patently ludicrous excuses for shutting down entrepreneurs. A court upheld Louisiana's florist-licensing scheme, for example, because requiring florists to take a test, which would be graded largely on the subjective beauty of their floral arrangements, might help protect the public from "infected dirt."

The true victims of this new "favored pastime" are people like Clemens and countless other Americans, honest individuals whose lives have been turned upside down solely to protect the politically powerful. Such examples are seemingly endless.

In Texas, all computer-repair technicians must now become private investigators. "If you're investigating or analyzing data, then you should need a little more credentials than someone who just repairs computers," the legislative sponsor said. The PI license requires a criminal-justice degree—or a three-year apprenticeship under a licensed private investigator. If a consumer knowingly takes his computer to get repaired by an unlicensed specialist, he faces thousands of dollars in fines and a year in jail. This law no doubt benefits special interests, but those benefits come directly at the expense of ordinary repair technicians and their customers.

A new law in Philadelphia will make it a crime in the coming weeks to talk about the Liberty Bell for money without the government's permission. Unlicensed tour guides will be subject to hundreds of dollars in fines for talking about the place where the Declaration of Independence was written.

Perhaps the most well-organized cartelization effort underway in the United States today is in the interior-design industry. A powerful faction of insiders has already put thousands of its competitors, mainly middle-aged and elderly women, out of work.

The American Society of Interior Designers (ASID) represents less than 3 percent of all designers, but its members have designated themselves as spokespeople for the entire industry. In over 30 years of lobbying, ASID has never presented a single shred of evidence to support its extraordinary claim that literally "every decision an interior designer makes affects life safety and quality of life."

ASID has been relentless in teaming up with legislatures coast to coast in its strategy for total cartelization. IJ has documented these efforts in a study titled "Designing Cartels" (http://tinyurl.com/6y6aqg).

Such laws exist today for one reason: Our nation's judicial system fails to protect the right to earn a living. Courts have decided that this fundamental right—economic liberty—is simply not as important as other rights, and less-important rights are thus not subject to meaningful judicial scrutiny and rarely are afforded protection under the law. If the government can simply dream up a conceivable reason for violating economic liberties, even if that reason is based on no facts, the regulations are generally upheld. Amazingly, courts will even help by inventing their own hypothetical rationales for economic protectionism. This system does not just stack the deck—it gives the politically powerful a hand full of jokers.

Thankfully, entrepreneurs are fighting back. Taxicab drivers, African hair-braiders, sign-hangers, waste haulers, casket sellers, and others have battled the odds (with help from IJ) to strike down occupational-licensing schemes.

Mercedes Clemens's lawsuit has already caused one of the licensing boards to backpedal. The Philadelphia tour guides, now represented by IJ, had a hearing in federal court on October 6. In Texas, computer-repair technicians and interior designers are standing up for their constitutional rights.

F.A. Hayek famously wrote that "the great aim of the struggle for liberty has been equality before the law." That is precisely what the fight for economic liberty is all about. FEE

Lost in Transcription

BY SHELDON RICHMAN

Following rules, such as the rules of language, of the market, or of just conduct, is more about "knowing how" than "knowing that." This is a lesson taught by many important thinkers, among them, Gilbert Ryle (who used these terms in the title of chapter 2 of *The Concept of Mind*), F.A. Hayek, and Ludwig Wittgenstein. On many matters, we know more than we can say. Yet we are tempted to identify knowing with saying. It's a temptation best resisted.

Language, economic activity, and law did not begin when someone published a grammar book, an economics text, or a political treatise that people then used to guide their actions. On the contrary, the books were written after the fact to codify what people had long been doing. And, importantly, the books could never fully describe what people had been doing or would do in the future. At best they were imperfect codifications that couldn't possibly capture all the details involved in applying the rules to the varied circumstances of everyday life. In truth, they weren't rules—in the formal, self-conscious sense—until the books were written. Yet they "governed" behavior.

Language, economic activity, and law did not begin when someone published a grammar book, an economics text, or a political treatise that people then used to guide their actions.

"For not only do we not think of the rules of usage—of definitions, etc.—while using language, but when we are asked to give such rules, in most cases we aren't able to do so," Wittgenstein writes. Think how children learn something as complex as language and social roles.

Ryle puts it this way: "Rules of correct reasoning were first extracted by Aristotle, yet men knew how to avoid and detect fallacies before they learned his lessons, just as men since Aristotle, and including Aristotle, ordinarily conduct their arguments without making any internal reference to his formulae. They do not plan their arguments before constructing them. Indeed if they had to plan what to think before thinking it they would never think at all; for this planning would itself be unplanned."

Important Implications

This fact about rules has important implications for the struggle for the free society. The belief that basic rules and social institutions are and can be the product of conscious design leads to the social engineer's conviction that society can be *redesigned* according to a detailed plan. That conviction easily leads to intolerance of those who won't go along with the plan. It's a short step to proposing that the uncooperative be liquidated—for the common good.

If in fact society could not have been successfully designed, it follows that it cannot be successfully redesigned. Societies are too complex, and people will stubbornly cling to their tacit rules even in the face of draconian penalties.

What might this tell us about the classical-liberal notion of individual rights? It seems to say that no society went from illiberal to liberal the day some political philosopher read his treatise of government to the assembled masses in the public square. By the time the treatise would have been written, the customs of ordinary people would already have largely embodied what we call natural rights. It is even possible—perhaps likely—that the formal expression of those rights got them wrong. Something was lost in the transcription.

Sheldon Richman is the editor of The Freeman *and a contributor to* The Concise Encyclopedia of Economics.

This is largely what the legal philosopher John Hasnas is getting at in his remarkable paper "Toward a Theory of Empirical Natural Rights," published in *Social Philosophy and Policy* in 2005. The juxtaposition of "empirical" and "natural" only appears contradictory. What Hasnas sets out to do is to show how individual rights could "*evolve* in the state of nature," that is, "in the absence of established government, [but] not in the absence of any mechanism of interpersonal governance."

How might that happen? In the state of nature there are problems to be solved. A small number of people use violence in attempting to live off the productive efforts of others. Besides that, disagreements over contracts and ownership arise among even the peaceful. In response, and contra Hobbes, "Various methods of providing for mutual protection and for apprehending or discouraging aggressors are tried. . . . Simultaneously, nonviolent alternatives for resolving interpersonal disputes among the productive members of the community are sought. . . . Those [methods] that effectively resolve the disputes with the least disturbance to the peace of the community continue to be used and are accompanied by ever-increasing social pressure for disputants to employ them.

"Over time, security arrangements and dispute settlement procedures that are well-enough adapted to social and material circumstances to reduce violence to generally acceptable levels become regularized. Members of the community learn what level of participation in or support for the security arrangements is required of them for the system to work and for them to receive its benefits."

Self-interest impels these developments. The overriding aim of the trial-and-error process is to minimize violence so the business of flourishing through social cooperation may proceed. Rights are thus born of problem-solving.

From Theory to Practice

Now this is a nice theory, but what about practice? Hasnas illustrates the validity of his story by pointing to two "state of nature" episodes in history: Anglo-Saxon and early Norman England, and the rise of the Law Merchant in medieval Europe. In the first instance, "The process of negotiating settlements of potentially violent conflicts and repeating and eventually institutionalizing successful resolutions gradually produced a broad body of customary law that served as the basis for the England common law."

In the second, beginning in the eleventh century, and in the absence of a transnational government, merchants from different cultures and language groups who were engaged in global commerce looked for a way to protect themselves from predation and conflict when away from home. "[M]erchants sought arrangements that provided the needed assurance. . . . The merchant courts that evolved in this way eventually grew into a European system of commercial courts in which merchant judges quickly applied the tenets of the Law Merchant to resolve commercial disputes."

Today we think law is something only legislatures produce, but that is not the case.

In both of Hasnas's examples, effective law respecting individual freedom was generated apart from the state and only later was absorbed—with state-serving distortions—into a formal governmental system. Today we think law is something only legislatures produce, but that is not the case. Strictly speaking, legislatures do not produce law at all. They issue decrees.

The "rights" that grew out of these spontaneous processes are recognizable as the rights to life, liberty, and property. Yet, Hasnas acknowledges, they did not perfectly match the natural rights of the philosophical treatises. Nevertheless, the process Hasnas describes gets us a long way down the road to freedom.

No law book will ever be able to describe rights and their application down to the minutest detail once and for all. As noted at the outset, rules are not of that nature. Conflict-resolution procedures that address particular disputes between particular parties as they arise will always be necessary, and such resolution will produce (or identify) additional law. The question is whether we want competition or monopoly in the production of law. FEE

The Threat of Tax Centralization Hovers Over Europe

BY PIERRE BESSARD

Are Europe's politicians about to undo one of the most decisive safeguards for freedom on the Old Continent? These days the talk in European chancelleries is all about clamping down on citizens who seek to protect their wealth in more amicable environments. The European Union and its predecessors have been progressively centralizing tax systems in Europe since the 1960s. But with bloated, unreformed welfare states confronted with unfavorable demographics, politicians are now more desperate than ever for revenue. The consequences are increasingly disquieting.

One of the most visible measures against European citizens is the German secret service's purchase earlier this year—for 4.2 million euros—of client data stolen by an employee of a private Liechtenstein bank. Peer Steinbrück, Germany's finance minister, described it as "an investment with a sensational return, the deal of my life." It is expected that the German government will confiscate at least 300 million euros of undeclared wealth. In a gesture akin to sharing the loot among comrades-in-arms, the German government passed on banking data concerning citizens of other countries to its respective counterparts. The support of both the EU and the Organization for Economic Cooperation and Development (OECD) for the German government's action left no doubt that from now on the end would justify any means.

Meanwhile, the most productive Germans are fleeing the country, most to take up residence just south of the border, in non-EU Switzerland, causing even more frustration in Berlin. In the last four years no fewer than 68,000 Germans chose to emigrate to the Alpine republic, where the tax burden is on average a third lower. In 2007 alone, 29,309 German citizens made Switzerland their home—a historical record. But the Germans, as the French and Italians have notoriously done for a long time, are also evading the state within its own borders. With the largest tax increase since the end of World War II implemented by the Merkel government in 2007, the German underground economy is estimated to have grown to 14.7 percent of gross domestic product last year. Faced with such trends, no wonder Europe's politicians are becoming increasingly nervous.

> Politicians are now more desperate than ever for revenue.

In their fight for self-preservation, the EU is a welcome tool. It can be used to make less competitive those countries deemed too attractive and thereby stem the citizens' option of last resort: "voting with their feet" and leaving their country altogether. The EU is even reintroducing control of cash movements. Travelers entering or leaving the EU are now required to make a declaration to customs authorities if they are carrying "cash of an amount of 10,000 euros or more (or its equivalent in other currencies or easily convertible assets such as non-crossed checks)." Undeclared cash may be "detained." Almost 20 years after the fall of the Berlin Wall, the European Union is busy building new barricades.

Pierre Bessard (pb@libinst.ch) is president of the Liberales Institut in Zurich and executive director of the Institut Constant de Rebecque in Lausanne, Switzerland.

"Coordinating" Tax Policy

Tax centralization at the EU level progresses at a much faster pace than is generally perceived. Although the EU denies being concerned about tax rates, the European Commission, backed by high-tax governments, openly pursues the protection of its member states' tax revenues against "harmful tax competition" and promotes the "coordination" of tax policy. The Commission thinks that upholding the unanimity rule for all tax decisions—a rule that still applies—will make it difficult to achieve the tax coordination it strives for. It has therefore proposed a switch to qualified-majority voting in many tax areas. To facilitate short-term advances, the Commission has also begun to favor "soft" but politically influential measures by drawing up "codes of conduct" and recommendations rather than legislative proposals. Closer forms of cooperation among groups of states sharing the same position are also pursued.

> The EU seeks to track European taxpayers by aiming for as extensive an exchange of information among tax authorities as possible.

The EU seeks to track European taxpayers by aiming for as extensive an exchange of information among tax authorities as possible. The most striking example of this is the Savings Tax Directive, in effect since mid-2005, under which each member state must set up an "automatic exchange of information" to notify other member states when their citizens earn interest income outside their home countries. Only Belgium, Luxembourg, and Austria are being permitted a transitional period during which they levy a withholding tax instead of violating bank secrecy. The EU so far has also signed equivalent withholding agreements with five nonmember European states, including Switzerland, that have refused to set up an automatic exchange of information. Although the EU directive has been downplayed as being full of loopholes, in 2007 the withholding tax resulted in an additional burden of 653 million Swiss francs for EU residents saving their assets in Switzerland, and the EU now seeks to extend the agreement to other financial transactions.

Faced with the global mobility of capital, the European Commission is also attempting to include Hong Kong and Singapore in its international chase of EU savers, though unsuccessfully so far. The Asian jurisdictions are more reluctant to turn themselves into agents for the European tax authorities. In the United States, where according to an official survey European residents have deposited more than $1.7 trillion, the government refused to reply to the European Commission's invitation to abide by the directive. The Commission is also contemplating the inclusion of Bahrain, the Bahamas, Canada, Dubai, Macao, and even Japan in its plans. This is clearly the next logical step in the EU's ambitions: a global tax cartel designed to follow European "tax evaders" fleeing from what must be seen, by the same analogy, as the EU's "tax prison."

On the corporate front, European governments are even bolder. The German and French finance ministries intend to push the long-standing proposal of a "common consolidated corporate tax base"—a standardized measure for corporate income taxes. It is obvious that such a project is an important step toward tax centralization. The German finance minister makes no secret of it and has already called for a minimal tax rate of 30 percent on corporate income. He can count on support from the European commissioner for taxation, Lázsló Kovács, a former Hungarian communist apparatchik, who insists that "tax obstacles" would be lifted by a uniform approach. In much the same way as the planned economy was supposed to eliminate the costly duplication of market competition, the common tax base is supposed to eliminate the compliance costs of 27 tax authorities. Although competition between states, which enjoy territorial monopolies, cannot really be compared to market competition, experience shows where tax centralization leads.

In the case of the value-added tax (VAT), the EU similarly started by homogenizing the different tax bases. Later, at the insistence of the German government, it ended up standardizing the minimum VAT rate at 15 percent. At that time all countries went along because few governments could resist the comfort of a Europe-wide tax floor for a tax that collects more than a third of all revenues across the EU. Besides the VAT, the EU has also standardized excise taxes on alcoholic beverages, manufactured tobaccos, and energy products. With the customs union, the EU has also standardized tariffs and agricultural duties, which go directly into its budget. Estonia, for example, which had a more open trade policy, had to adopt the 10,794 tariffs in effect in the EU when it joined the organization. Tariff centralization prevents any country from moving to a more open trade policy and initiating a virtuous circle of trade liberalizations through emulation.

"Fiscal State Aid"

The Commission also uses the dubious concept of "fiscal state aid" to force more "competitive" governments to discontinue attractive tax regimes. This conceptual drift is hazardous in more than one respect. First, by considering less onerous taxation as equivalent to a subsidy, the Commission makes no distinction between "not taking" and "giving." Second, by characterizing less-heavy taxation as "aid," the Commission explicitly implies that all resources belong to the state, which is then entitled to allocate them between the private and state sectors. This political appropriation of resources is striking when the Commission defines state aid—including "fiscal state aid"—as "state resources in any form whatsoever which distorts or threatens to distort competition."

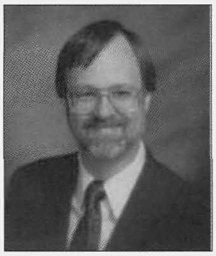
No other tax dispute demonstrates the EU's bad faith as clearly as its current disagreement with Switzerland. Last year the Commission declared that some longstanding Swiss tax rules applicable to administrative, holding, and service companies constitute a form of state aid incompatible with the proper functioning of the 1972 free-trade agreement between Switzerland and the other European nations. The Commission was only taking up complaints introduced by some member governments, members of the European Parliament, and corporations. There can be no doubt that the intervention against Switzerland serves to protect the least competitive member states' tax revenues and, in the case of corporations, to raise the production costs for competitors headquartered in Switzerland.

The Swiss government has until now steadfastly refused to enter into negotiations with the EU. But both the German and French governments, emboldened by the recent Liechtenstein case, have promised to intensify their fight against "tax havens." The political pressure on fiscally more attractive locations, as well as the pursuit of European savers who attempt to protect their assets outside their own countries, is steadily undermining Europe's greatest strength: its diversity. Jurisdictional diversity and the dispersion of power were decisive factors for the Renaissance, the Enlightenment, the Industrial Revolution—and the great prosperity that followed.

Jurisdictional diversity and the dispersion of power were decisive factors for the Renaissance, the Enlightenment, the Industrial Revolution—and the great prosperity that followed.

By limiting the ability of people to vote with their feet and take their capital with them, tax centralization favors higher tax burdens and undermines property rights. It also encourages unsustainable welfare policies and pervasive market regulation, while hampering institutional innovation through observation and emulation of best practices. The European tax cartel-in-the-making threatens to undo the conditions responsible for Europe's exceptional success and lift some of the last constraints on its high-spending, hopelessly paternalistic governments. FEE

Andrew Mellon: The Entrepreneur as Politician

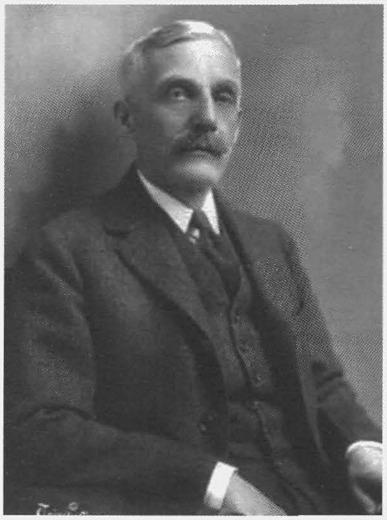


BY BURTON FOLSOM, JR.

Rarely do spectacular entrepreneurs leave their realm of business for the political arena. One exception is Andrew Mellon, the third-wealthiest American of his era, who left a dazzling career in American industry to become secretary of treasury under Presidents Warren Harding, Calvin Coolidge, and Herbert Hoover.

Mellon established his career in Pittsburgh as a successful banker—always on the lookout for profitable innovations to back. His investments in Gulf Oil challenged the legendary John D. Rockefeller, and Mellon's establishment of Alcoa introduced lightweight aluminum as a significant industrial metal.

Should Mellon have given up running these and other profitable ventures in 1921 to work under President Harding, a career politician who had little understanding of economics? Mellon hesitated. But when Harding persisted, Mellon joined the president's cabinet. At age 65, Mellon had experienced a full career in business; his country, which was in economic chaos after World War I, had 11.7 percent unemployment and needed his financial guidance.



Andrew Mellon

Confronting Crises

As treasury secretary Mellon confronted three major crises: a spiraling national debt, near confiscatory tax rates, and the repayment of large loans owed the United States by most European nations.

The soaring national debt required immediate attention. During the 140 years from the American Revolution to 1916, the United States had accumulated a national debt just over $1.2 billion. But during World War I the debt had skyrocketed to more than $24 billion. The annual interest payments alone exceeded the entire national debt before the war.

The U.S. tax system, which generated the revenue to pay the debt, was in disarray. Under President Woodrow Wilson, Harding's predecessor, the income tax had become part of American life. Wilson started with a top marginal rate of 7 percent, but he argued that the war required a drastic rise in taxes. Congress agreed, and by 1920, Wilson's last full year in office, the top rate reached 73 percent. Tax avoidance was rampant, and the annual revenue did not offset expenses.

Finally, the debts that the European allies owed the United States for food and materials during the war were over $10 billion. Britain and France, which owed the most, were balking at repayment.

Few secretaries of the treasury have ever encountered such formidable problems, and Harding (who died in 1923) and Coolidge relied on Mellon for financial advice. Mellon's attack on the debt was twofold. First, he renegotiated almost one-third of the debt at lower interest rates; second, he helped chop federal spending from $6.5 billion in 1921 to $3.5 billion in 1926. Coolidge, in particular, obliged by vetoing special-interest legislation—a bill to give a bonus to veterans and another to subsidize wheat and cotton farmers.

Mellon was not always consistent in his free-market arguments. He supported high tariffs for many products, but he recognized that a "subsidy can be paid only by taking money out of the pockets of all the people in order that it shall find its way back into the pockets of some of the people."

Burton Folsom, Jr. (Burt.Folsom@Hillsdale.edu) is a professor of history at Hillsdale College, FEE's senior historian, and author of New Deal or Raw Deal? *(Simon & Schuster, 2008).*

Mellon, meanwhile, did his part to promote thrift. He cut staff at the Treasury Department, and he reduced the size of America's paper money; the smaller bills were more durable and saved ink and paper.

The slashing of the tax rates, however, was where Mellon did his most good. He carefully studied the effects of confiscatory rates and concluded that most wealthy Americans were avoiding payment of taxes by exploiting tax loopholes—foreign investments, the buying and selling of art and coins, and the purchase of tax-exempt bonds.

Why not, Mellon argued, cut the top rate from 73 to 25 percent? In fact, why not chop all rates by the same proportion? That idea—which would be called the Mellon Plan—would not only encourage the rich to invest in the American economy, it might actually generate more revenue. "It seems difficult for some to understand," he wrote, "that high rates of taxation do not necessarily mean large revenue to the Government, and that more revenue may often be obtained by lower rates."

Coolidge fully backed the Mellon Plan, and Congress passed it in stages during the 1920s. Cutting both federal spending and tax rates across the board worked wonders for the American economy. American businessmen plowed capital into radios, cars, refrigerators, vacuum cleaners, telephones, and a variety of new inventions from the air conditioner to the zipper. Entrepreneurs knew they would be able to keep most of what they invested, and the American economy grew rapidly during the 1920s.

> Cutting both federal spending and tax rates across the board worked wonders for the American economy.

Measuring Misery

One measure of prosperity is the misery index, which combines unemployment and inflation. During Coolidge's six years as president, his misery index was 4.3 percent—the lowest of any president during the twentieth century. Unemployment, which had stood at 11.7 percent in 1921, was slashed to 3.3 percent from 1923 to 1929. What's more, Mellon was correct on the effects of the tax-rate cuts—revenue from income taxes steadily increased from $719 million in 1921 to over $1 billion by 1929. Finally, the United States had budget surpluses every year of Coolidge's presidency, which cut about one-fourth of the national debt.

On the issue of the Allied loans, Mellon was less successful. When the Europeans refused to begin payments on their debts, Mellon substantially lowered the interest rates on the loans and gave the Europeans 62 years to repay. At first, they agreed, and even began making small payments, but only Finland paid off its entire debt. The other countries eventually asked for a moratorium on payments, and then abandoned their debts entirely.

Oddly, the Allies had one good argument for reneging on their debts. In 1930, when the United States passed the Smoot-Hawley Tariff, the highest in American history, Europeans asked how they could repay their loans when the United States was refusing to accept their imports? Hoover ultimately appointed Mellon as ambassador to England—in part to nudge the British into honoring their debt commitment—but with the Great Depression under way, even Mellon's powers of persuasion failed to move the British.

By 1933, with the arrival of Franklin Roosevelt and the New Dealers, the times had changed for Mellon. Hoover had raised the top marginal income tax rate to 63 percent, and Roosevelt hiked it to 79 percent in 1935. Moreover, Roosevelt played politics and pressured the IRS to assess Mellon a $3 million fine for tax evasion. Mellon gladly went to court and was vindicated of all charges of wrongdoing. David Blair, the former commissioner of internal revenue, called the tax investigation "unwarranted abuse by high officials of the government."

Mellon, despite the trumped-up charges, always focused optimistically on the art of the possible. Before his death in 1937 he donated his superb art collection to the United States. In doing so, he wanted to avoid all federal expense, so he built the National Gallery of Art in Washington, D. C., to house the paintings and then donated all of it to his country. When Mellon went to Washington, he changed it more than it changed him. FEE

Eimi Mine

BRUCE EDWARD WALKER

E. E. Cummings is one of the most beloved American poets of the twentieth century. He perhaps is best known to contemporary readers for his experimental and playful verse in the Modernist tradition. But he also wrote two important prose works that unfortunately have been relegated to relative obscurity. The first, *The Enormous Room,* is a fictionalized retelling of his incarceration in France for alleged treason during World War I. The second, *Eimi,* which celebrates the 75th anniversary of its first publication this year, is a reworking of his travel journals to the USSR in 1931.

E.E. Cummings
Library of Congress

Eimi is a difficult yet rewarding literary exercise, depicting as it does the true nature of collectivist ideology as practiced during the relatively early years of the Stalinist regime. Although Cummings regarded the work as a novel, some critics consider it a travel book, while others consider it a polemic against communism as practiced in the Soviet Union. This reader would argue that Cummings's penchant for coining new words by combining two or more terms—technically referred to as portmanteau words—carried over to his expansion of his coded travel journals for *Eimi,* which, like his poetry, is wildly inventive, syntactically jumbled, frequently comic, presented in a fashion that must've given typesetters nightmares, and unmistakably original. In short, *Eimi* is all of the above—a novel, travel journal, and polemic. Most of all, however, it is a deeply personal expression of the author's primary thematic concerns of retaining one's individuality in the face of social and political pressures to conform to the collective.

An Unpopular Work

Immensely unpopular with the Western cultural left because of its negative assessment of the restrictive nature and infertile artistic soil inherent under tyrannical rule, *Eimi* burned Cummings's bridges with a host of writers and editors. According to teacher and editor Jenny Penberthy, writing in the *Dictionary of Literary Biography*:

> During the writing of "Eimi," Cummings' antagonism to the Soviet Union became an obsession. He grew to despise both Communists *and* liberals. . . . Before "Eimi" he had been regarded as a voice from the left because of the antiauthoritarian demeanor of his poems and "The Enormous Room." He lost friends and the once unquestioning support of a literary world now increasingly sympathetic to literature fueled by a social conscience.

Bruce Edward Walker (walker@mackinac.org) is communications manager for the Property Rights Network of the Mackinac Center for Public Policy. He has been an adjunct professor of literature and academic writing at the University of Detroit Mercy.

In fact, the book was briefly out of print after its initial 1933 publication, was reprinted in 1949 and 1958—the same year Cummings was awarded the Bollingen Prize—then wasn't reprinted again until 2007.

The tenor of the times during which *Eimi* was inspired and written—colored as it was by the remembered horrors of World War I—was rife with leftist political remedies to perceived social ills. Freedom and free markets all took a beating from the New Deal programs of the Roosevelt administration; the rise of Marxist governments in Spain, Eastern Europe, and Asia; fascism in Italy; and national socialism in Germany. The cultural intelligentsia served as useful idiots for centralized governments, from Wyndham Lewis writing of his favorable impressions of early Nazi Germany to Ezra Pound notoriously broadcasting fascist propaganda to Allied troops from Italy during World War II.

The tenor of the times during which *Eimi* was inspired and written—colored as it was by the remembered horrors of World War I—was rife with leftist political remedies to perceived social ills.

The Literati and Marxism

Marxism in general and the Soviet experiment in particular, however, held an even greater appeal for the literary cognoscenti, beginning with playwright George Bernard Shaw's work espousing socialist ideas in the early twentieth century and blossoming with the Oxford poets Stephen Spender, W.H. Auden, and Cecil Day-Lewis in the 1930s and such American writers disillusioned with capitalism as the Group Theatre playwright, folk singers Woody Guthrie and Pete Seeger, and novelist John Steinbeck. Other notable writers immersed in communist folly included Arthur Koestler, Richard Wright, Ignazio Silone, Louis Fischer, and André Gide—all of whom repudiated their youthful indiscretions in five individual essays (joined by another essay by Spender) collected in *The God That Failed* (1949). As for Auden, he famously rejected political solutions when he wrote, "[P]oetry makes nothing happen" in his "In Memory of W.B. Yeats," which was written as the world once again prepared for wide-scale war in the late 1930s.

Eimi also found disfavor among literary critics and the public at large because of the experimental and sometimes impenetrable nature of Cummings's prose style. Even Pound, not known for writing easily understood poetry, complained that a work exceeding 400 pages could benefit from extended passages of clarity: "BUT, the longer a work is the more and longer shd. be the passages that are perfectly clear and simple to read." Indeed, reading the book does require patience and intense concentration; even then, whole pages can leave even the most dedicated reader scratching his head. Some of this confusion was alleviated by a preface Cummings added for the 1958 edition.

Yet the book's importance as both a literary achievement and exposé of Soviet repression can't be expressed sufficiently. No less a critic than Pound assessed *Eimi* as the final volume of the quintessential Modernist prose trilogy begun with James Joyce's *Ulysses* (1922) and Wyndham Lewis's *The Apes of God* (1930). The poet Marianne Moore declared that *Eimi* wasn't a prose work at all, but "a large poem" in the Modernist tradition of, presumably, T.S. Eliot's "The Waste Land," Archibald MacLeish's "The Hamlet," and Pound's "The Cantos." Critic Richard Kennedy's close reading of the book contains a fitting depiction of Cummings's attempt to reveal the dehumanizing elements of the Soviet system:

> Soviet Russia as pictured in *Eimi* seems the complete negation of Cummings' philosophy of "Is," that human beings should live so as to express their own individuality—to be "alive"; to place a value on feeling, on growing, on diversity, on "being continually born"; to pursue happiness; to cherish freedom; to rejoice in pleasure; to give and respond to love. Cummings felt that the Soviet system was stifling the life out of its people. Everywhere in Moscow he sensed "nonlife" or mere "undeath." He found fear, guilt, and a dispirited sameness; a "whichness and

whatness" instead of a "whoness"; a lack of laughter; a suspicion of pleasure ("in Russia, everybody's leisure is organized," . . .); and emphasis on forced behavior.

The Artist and Individuality

Prompted by fellow writer John Dos Passos, Cummings traveled to Russia via Paris to witness first-hand the presumed artists' paradise. Dos Passos, incidentally, also passionately and famously denounced communism as "groupthink" after his extended stint as a fellow traveler—with the concomitant decline in book sales and popularity all too common for writers who failed to adhere to the Communist Party line.

In *Eimi*, as in most of his poetry, Cummings was more interested in the ideal circumstances under which an artist could express his or her individuality rather than aligning with one political solution over another. Nowhere is this theme more apparent than in the title of the book, which is Greek for "I am." For Cummings, to live in the "was" rather than the "is" or "am" is a manner of existence that he perceived as subhuman and lifeless.

Appreciating Cummings's idiosyncratic sensibility is critical to understanding the bulk of his art. Cummings's worldview was shaped by his youth in Cambridge, Massachusetts, where his father was a Unitarian minister and sociology professor at Harvard. As a poet and painter, he fully adopted the tenets stressing the artistic freedom and individuality of the New England Transcendentalist and English Romantic traditions, which he later adapted to the Modernist ambition of capturing a moment or movement as espoused by Pound, Gertrude Stein, and the Cubist painters. He also was an ardent follower of popular culture, especially burlesque theater. He wrote in the preface to his poetry collection "is 5" (1926):

> My theory of technique,if I have one,is very far from original; nor is it complicated. I can express it in fifteen words, by quoting the Eternal Question and Immortal Answer of burlesk, viz. 'Would you hit a woman with a child?—No, I'd hit her with a brick.' Like the burlesk comedian, I am abnormally fond of that precision which creates movement.

Documenting the Effect of Soviet Rule

An adherent of no specific political stripe, but a staunch defender of his own individuality, Cummings documented the grayness of what he called the un-people populating the Russian cities he visited, as well as what he perceived as the sorry state of art in a country that required its poets, filmmakers, dancers, and composers to celebrate the proletariat.

Cummings's first experience with the stifling nature of Soviet rule appears in the book's opening chapter. He approaches a half-bald clerk at a Polish railway station, which leads to the following encounter:

> Why do you wish to go to Russia?
> Because I've never been there.
> (He slumps,recovers). You are interested in economic and sociological problems?
> no.
> Perhaps you are aware that there has been a change of government in recent years?
> yes(I say without being able to suppress a smile).
> And your sympathies are not with socialism?
> may I be perfectly frank?
> Please!
> I know almost nothing about these important matters and care even less.
> (His eyes appreciate my answer). For what do you care?
> my work.
> Which is writing?
> and painting.
> What kind of writing?
> chiefly verse; some prose.
> Then you wish to go to Russia as a writer and painter? Is that it?
> no; I wish to go as myself.
> (An almost smile). Do you realize that to go as what you call
> Yourself will cost a great deal?
> I've been told so.
> Let me earnestly warn you(says the sandyhaired spokesman for the Soviet Embassy in Paris)that such is the case. Visiting Russia as you intend would be futile from every point of view. The best way for you to go would be as a member of some organization—but,so far as I know,I'm not a member of any organization.

Much as Joyce borrowed the framework for his Modernist novel *Ulysses* from Homer's *Odyssey*, Cummings borrows the schematic for *Eimi* from Dante's *Divine Comedy*, with his Soviet experience echoing Dante's descent into Hell. As he clarified in his 1958 preface:

> eimi,first published in 1933,is the diary(May 10-June 14 1931)which I kept during most of a trip from Paris to Russia, thence to Turkey,& back to Paris. When my diary opens,I'm on a train bound for the Polish-Russian border. At N(negereloe)I enter a 'world of Was'(p 8)—the subhuman communist superstate,where men are shadows & women are nonmen;the preindividual Marxist unworld. This unworld is Hell. In Hell I visit Moscow, Kiev,Odessa. From Hell an unship takes me to Istanbul (Constantinople)where I reenter the World(pp 393-403)—returning to France by train.

A Modern Inferno

In Cummings's novel, the role of Dante's Underworld guide Virgil is filled by the American theater critic Henry Wadsworth Longfellow Dana. Dana was a longstanding friend of Cummings's from their days at Cambridge and an ardent communist and promoter of Soviet theater.

After falling out with Dana—whom he eventually finds too ideologically hidebound—Cummings abandons him without leaving so much as a goodbye note. Cummings then takes up with Joan London, daughter of Jack London (another American writer with socialist sympathies), and her husband, Charles Malamuth. Cummings, after Dante, nicknames London "Beatrice." By the time Cummings (referred to as Comrade Kemmin-kz in the book) arrives in Moscow, the couple has reached the end of their patience with the Soviet design, as articulated by Malamuth to a Midwestern American tourist couple the trio encounters:

> [N]ot all of these knowing millions can tell you a single god damned thing; because they're Russians. Do you understand? Russians. All of them are inside communism; not outside it, as you are. All of them are actually living(or dying)an unprecedented experiment, not merely observing it with an analytic eye; far less dreaming about it with a sentimental brain. . . . Russians in Russia must suffer and shut up. . . . But correspondents in Russia have special privileges. They can't get a really good story past the Russian censor, of course:but they don't have to swallow their tongues while they're here and they're not obliged to be here forever.

By the time Cummings leaves the USSR, he has seen enough to color his view of the collective spirit and government sponsorship of the arts for the remainder of his life. As his train nears the Turkish border, he seethes:

Throughout Eimi Cummings describes the Soviet Union as a shut window.

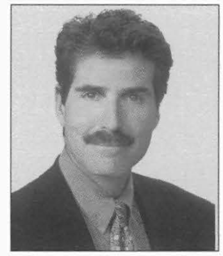
> USSR a USSR a night-USSR a nightmare USSR home for the panacea Negation haven of all(in life's name)Deathworshippers hopper of hate's Becausemachine(U for un- & S for self S for science and R for-reality)how it shrivels:how it dwindles withers; how it wilts diminishes wanes; how it crumbles evaporates collapses disappears—the verily consubstantial cauchemar of premeditated NYET.

Throughout *Eimi* Cummings describes the Soviet Union as a shut window. The book opens: "SHUT seems to be The Verb"; and closes powerfully as Cummings returns to Paris with the lines:

> "Voice
> (Who:
> Loves;
> Creates;
> Imagines)
> OPENS

Learning from *Eimi*

Poetry is seldom taught thoroughly in many schools today, and when it is, the canon has become shockingly slight. If Cummings is taught at all, it is only a few of his thousands of poems that remain anthologized: "next to of course god america i," "Buffalo Bill's," and "the Cambridge ladies who live in furnished souls"; or isolated incidences of poetic devices such as "anyone lived in a pretty how town" and "the world is mud-luscious . . . and puddle-wonderful." Even sparser in class curricula is the gravity of Cummings's documentation of his brief but memorable visit to the Soviet Union in 1931, which could serve as a beneficial entrée into the oeuvre of a writer who has for far too long received short shrift by cultural arbiters. More important, however, is the value of *Eimi* as a social-studies lesson for students, public-policy wonks, government officials, and artists willing to endure a first-person account of government oppression of the arts disguised as patronage. FEE



Tear Down the Stop Signs!

BY JOHN STOSSEL

Day after day in Warren, Michigan, people wait in a long line to pay traffic fines. Many are there because police say they didn't come to a full stop at a stop sign. Often the policeman saying that is Officer David Kanapsky.

I'm all for highway safety, but I suspect that America's roads have too many rules, and that gives cops too much arbitrary power to harass people or profit off them. As the ancient Chinese philosopher Lao-Tse said, "The more laws that are written, the more criminals are produced."

On a "20/20" segment earlier this year viewers heard a motorist in court insist that she did come to a complete stop. The judge replied, as judges there often do: "I find Officer Kanapsky's testimony to be credible. He is an unbiased witness."

But the officer is not really unbiased. The more tickets he writes, the more overtime he gets. Last year, Kanapsky spent so much time in court he increased his pay by $21,000.

Rolling through a stop sign in Michigan puts two points on your driving record. That hikes your car insurance premium. Fighting the ticket could cost even more. So to avoid the points and legal fees, most people plead guilty to a lesser offense: impeding traffic. The court sounds like an assembly line, ". . . no points . . . $135 . . . ."

Last year, the town made half a million dollars from such fines. Some drivers told us it "seems like a money-making scam."

I don't know if that's true, but when some angry motorists complained to Heather Catallo, reporter for Detroit's ABC affiliate, she took her cameras out to see if the cops themselves stopped at the stop signs. Most didn't.

Her exposé caused a ruckus in town. The mayor hired a new police commissioner, who told me the cops might have been on emergency calls. "They don't necessarily have to have their lights and sirens on," Commissioner William Dwyer said.

I told him the tape showed police cars rolling through stop signs on the way back to the police station.

"Did some officers make mistakes? Perhaps so," he said.

Dwyer denied the tickets were a moneymaking scam. He said he didn't think it odd that Kanapsky wrote thousands of tickets. "It's not unusual for a traffic officer to write 10 to 20 traffic violations a day, if not more."

Arbitrary Power

Please. I'm all for highway safety, but I suspect that America's roads have too many rules, and that gives cops too much arbitrary power to harass people or profit off them. As the ancient Chinese philosopher Lao-Tse said, "The more laws that are written, the more criminals are produced."

I bet most Americans roll through stop signs. I do. It makes for a smoother ride, and it saves gas.

"ABC News" put cameras by stop signs in Warren and in New York City. The video showed that in Warren, 72 percent of drivers did not come to a complete stop. In New York, 82 percent kept going.

John Stossel is co-anchor of ABC News' "20/20" and the author of Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong, *now in paperback. Copyright 2008 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

Warren and other towns probably have too many stop signs. There's no proof that more signs save lives. Studies show that sometimes installing stop signs lowers accident rates, but in some cases more accidents occur after signs are installed.

More Signs, Less Safety

In *Atlantic* recently, John Staddon argued that that America's omnipresent stop signs make us less safe. He wrote, "Stop signs are costly to drivers and bad for the environment: Stop/start driving uses more gas, and vehicles pollute most when starting up from rest. . . . [T]he overabundance of stop signs teaches drivers to be less observant of cross traffic and to exercise less judgment when driving—instead, they look for signs. . . .

"The four-way stop deserves special recognition as a masterpiece of counterproductive public-safety efforts. Where should the driver look?"

One Dutch town experimented by getting rid of most of its traffic signs. The result? Fewer accidents and fewer injuries.

Drivers look out for people instead of signs, and they negotiate their way through town.

Remember the stop sign in Warren, where Officer Kanapsky wrote many of his tickets? It's been changed to a yield sign. One result: fewer accidents.

Police say, "[B]etween Jan. 16, 2008, and May 21, 2008, there have been no accidents reported. During that same time frame in 2007, there were four crashes reported." Good. Let's get rid of more signs.

And to all the cops who eagerly punish us for doing what they do, give me a break. FEE

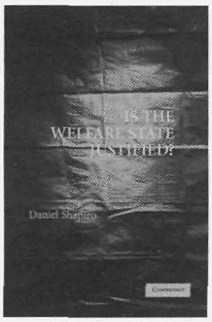
Book Reviews

Is the Welfare State Justified?

by Daniel Shapiro

Cambridge University Press • 2007 • 309 pages • $80.00 hardcover; $27.99 paperback

Reviewed by George C. Leef



Americans have lived with the welfare state for so long—more than 70 years—that for most, it is simply a fact of life. Asking whether it is justified would seem about as pointless as asking whether rain is justified. Furthermore, among the relatively few people who might be inclined to ponder the ethics of the welfare state, most subscribe to philosophies (for example, egalitarianism, positive-rights liberalism, and communitarianism) that find no fault with our panoply of welfare programs. Indeed, they generally favor expanding welfare.

Those of us who oppose the welfare state therefore have a Herculean task before us if we want to see voluntary programs replace coercive government ones. Fortunately, we have just gotten some help.

Professor Daniel Shapiro's book, *Is the Welfare State Justified?*, makes a strong effort at persuading nonlibertarians that, based on their own philosophical principles, they ought to give up their support for government programs such as Social Security and Medicare. It is a first-rate effort that should get intellectually honest defenders of the welfare state saying, "Well, that *is* a good point. . . ."

Readers should understand, however, that this is a work of *scholarship*. If you're simply looking for a few anti-welfare anecdotes to use against political opponents, you will have to go elsewhere. Throughout his analysis, Shapiro's writing displays a refreshing humility; he isn't looking for quick "gotcha!" points, but grapples earnestly with opposing perspectives.

Perhaps the reason Shapiro is so successful is that he used to be one of those liberal welfare advocates. But then he began to consider the libertarian critique. He writes, "Once I realized how free markets really worked, and how government programs that were supposed to realize their seemingly compassionate or just goals didn't really do so, I realized that the attitude of distrust I had toward government power and the view I had about the value of individual freedom applied to economic as well as personal matters." For quite a few years Shapiro (who teaches philosophy at West Virginia University) has been writing articles with titles like "Why Rawlsian Liberals Should Support Free Market Capitalism." In this book he brings decades of professional thought to bear on this important project.

All right, then—is the welfare state justified? No, but a short review can't do justice to Shapiro's work. He covers a great array of philosophical arguments, objections to arguments, and rejoinders to objections.

Let's briefly consider health care. Overwhelmingly, those on the political left reject free-market provision of health care, contending that everyone has a right to "adequate" medical services and concluding that we must adopt some version of a single-payer system to effectuate that claimed right. Shapiro responds that every sort of health-care system must deal with the rationing problem, then strongly argues that the free market more fairly solves that problem than any politically driven system can.

Similarly with old-age insurance and support for the indigent, Shapiro carefully shows why voluntary and market-based systems are preferable for meeting the needs of people—preferable from the standpoint of those who are inclined to believe that government does a better job.

In my view, Shapiro's most devastating argument against all forms of government welfare is his observation that there is no such thing as a governmental welfare guarantee. Here is what he writes:

> [W]elfare rights create significant conflicts with each other because even in an affluent society not everyone's needs can be met. The state must then pick and choose which needs are to be met (or whose needs are to be met or in what form they will be met) and in doing so, the sense in which there really are welfare rights becomes diluted if not transformed. Rather than one having a right to well-being that

> others (especially the government) *must* respect or honor, welfare beneficiaries become closer to supplicants who are at liberty to press their claims but are not entitled to them in a full-blown sense. [Emphasis in original]

Exactly! It is merely an illusion that government can create rights to welfare. All that politicians can do is to promise that they (including future officeholders) will use their coercive powers in an effort to deliver money, medical care, or other things to certain members of the population. But political promises are completely unenforceable, unlike contracts. That's one of the main reasons why Shapiro regards individual saving for retirement, medical care, and other needs as better than reliance on the state. With respect to money you have earned and saved, you really do have rights—contractual rights. You aren't just a supplicant begging politicians to tax others for your benefit.

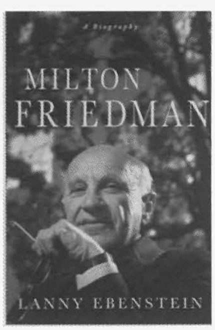
A splendid book that throws welfare state advocates on the defensive.

George Leef (georgeleef@aol.com) is book review editor of The Freeman.

Milton Friedman: A Biography

by Lanny Ebenstein
Palgrave Macmillan • 2007 • 286 pages • $27.95

Reviewed by E.C. Pasour, Jr.



In *Milton Friedman: A Biography*, Lanny Ebenstein presents a highly readable account of Friedman's life and an introduction to his economics, including his advocacy of libertarian ideas and government reform. The book is based on published material and personal interviews, and it was completed shortly before Friedman's death in late 2006. The appendix contains a "Bibliographical Essay" further elaborating on Friedman's life, work, and influence.

The first chapters describe Friedman's youth and early career. His family life, the TV program and book *Free to Choose*, his Nobel Prize, the Friedman Prize, and his work as adviser to Barry Goldwater and Presidents Nixon and Reagan are all discussed, but the book's major focus is on Friedman's mature career (1946–1976) at the University of Chicago. This is followed by a discussion of his life as a public figure following retirement.

Personal interviews reveal a number of interesting tidbits about him that will be new to most readers. For example, his family was apolitical and for much of his early life he was not much interested in politics.

Friedman is known worldwide now for his view that "Inflation is always and everywhere a monetary phenomenon." His early views on inflation, however, were quite different. In congressional testimony on how to avoid inflation during the early years of World War II, he focused on taxation as a way to reduce consumer spending.

Early on he proposed the free market as the most suitable vehicle to achieve "political freedom, economic efficiency, and substantial equality of economic power," even though he supported the welfare aspects of Roosevelt's New Deal as a young man. At the time the conventional wisdom among the public, as well as economists, was that government could manage the economy better than the market order could.

Friedman identified the Chicago school of economics with three attributes—efficacy of free markets, skepticism of government regulation, and emphasis on quantity of money in producing inflation. He contended that the University of Chicago was never primarily free market in outlook, but only seemed so; the distinguishing characteristic of Chicago "was not the presence of market-oriented scholars at Chicago but rather the absence of them elsewhere."

Friedman's *A Monetary History of the United States, 1867–1960,* coauthored with Anna Schwartz, was a major critique of Keynesianism. That work suggested that the economic turmoil of the 1930s was not due to excesses in the market order, but Federal Reserve policy that allowed the money supply to fall, which turned what might have been an ordinary recession into the Great Depression. This book had an important effect on economists' views on the appropriate role of government generally, but Ebenstein says little about the policy implications drawn by Friedman from the pathbreaking work in *A Monetary History.*

For much of his professional career Friedman was viewed as a heretic on the fringe of economics. It is hard to overstate the hostility to his policy ideas when *Capitalism and Freedom*—a libertarian guide to public policy—was published in 1962. It was reviewed only by the *American Economic Review*, even though accessible to a wide audience.

Ebenstein stresses Friedman's philosophical debt to F. A. Hayek, a colleague at Chicago from 1950 to 1962. Friedman considered Hayek the most important intellectual figure in the worldwide movement toward freer markets. Although each favored freer markets and less government, Hayek disagreed with Friedman's monetarism and his positivist approach to economics. Friedman, in contrast, considered his work in positive economics to be his primary intellectual contribution. Ebenstein discusses the shortcomings of the Hayekian subjectivist approach to economic analysis, but a similar discussion of the limitations of Friedman's positivist approach would have been informative.

The book's shortcomings mainly relate to what is omitted—discussion of Austrian, Keynesian, and other critiques of Friedman's work. It would have been interesting, for example, if Ebenstein had queried Friedman on his response to the Austrian position that governmental control over the supply of money and credit is so dangerous to economic stability that we would be better off if we could replace the Federal Reserve with some market alternative. Friedman once said that the gold standard led to the waste of resources in mining gold, but even if that is a waste, how does it compare with the damage done by governmental manipulation of money and credit?

Friedman's libertarian ethical view of the world was rooted in John Stuart Mill's *On Liberty*. Most readers will be surprised to learn that Mill put forth the idea of school vouchers almost a century before Friedman. Friedman's views on the financing of education evolved over time, and eventually he came to view vouchers as a means, not an end; by 2005 his ideal was government completely out of education.

Readers interested in Friedman's ideas, work, and personal life will gain by reading this book. FEE

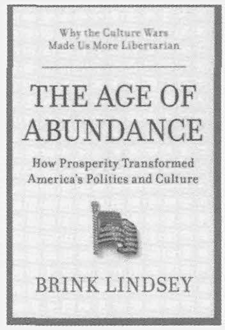
E. C. Pasour, Jr. (pasour@ncsu.edu) is Professor Emeritus of Agricultural and Resource Economics at North Carolina State University.

The Age of Abundance: How Prosperity Transformed America's Politics and Culture

by Brink Lindsey

Collins Business • 2007/2008 • 400 pages • $26.95 hardback; $14.95 paperback

Reviewed by J. Wilson Mixon



"If you're depressed about the state of politics these days, read *The Commanding Heights*. . . . Step back and look at the big picture, a picture that spans the whole planet and comes into focus over decades. Look at the big picture and see that our side—the side of human freedom—is winning." This review, written by Brink Lindsey in *Reason* in 1998 could be the first paragraph of his *The Age of Abundance,* a book that celebrates the virtues of liberty.

Lindsey, vice president for research at the Cato Institute, documents the advances in human freedom that Americans have enjoyed during the past century. He sees this age as one in which "most Americans were insulated from nature by an enormous edifice of human-created technologies and institutions." America's "age of abundance," he contends, is a product of and a contributor to Western modernity, whose four key elements are: reliance on open-ended experimentation rather than received knowledge; reliance on free markets and the trust required for their functioning rather than on command and personal ties; a political system in which government (at least in principle) arises from and answers to the people rather than despotism; and a social life in which individual and group advancement challenges traditional stratification.

In one of the book's many felicitous phrases, Lindsey asserts, "Despite all of the talk of raging 'culture wars,' most Americans are nonbelligerents." He concludes that most Americans are libertarians, happy to enjoy the economic fruits of the market system and willing to accept, if not embrace, the social diversity that system engenders.

Lindsey acknowledges the existence and importance of the culture wars. Indeed, he states the dilemma of the libertarian majority in an unpromising fashion:

"The prevailing ideologies of left and right are mirror images of one another. . . . The . . . left celebrates mass affluence's diversity and inclusiveness, while lacking due appreciation for the institutional and moral framework that sustains and advances progressive values. The right . . . defends that framework, but does so on the basis of dogmatic beliefs that remain unreconciled to mass affluence's cultural openness. [Politically, those in the libertarian majority must] choose which illiberal bedfellows they dislike least."

The disproportionate influence of voices on the left and right militates against the articulation of the liberal position that Lindsey thinks those in the upwardly mobile middle class would favor.

As a result, "the modus vivendi that has emerged . . . is an unspoken and unloved compromise rather than a well-articulated and widely embraced consensus."

Here the author might have fruitfully incorporated some insights offered by Bryan Caplan in his book, *The Myth of the Rational Voter.* Caplan's analysis warns that the problem is not just lack of confidence. Rather, the average voter's economic sophistication compares to the average flat-earther's geographic sophistication. This endemic lack of sophistication, coupled with the strength with which statists hold on to their views, suggests that Lindsey's admirable attempt to show the way to a truly liberal society will convince too few.

The book's generally excellent review of history suffers from a related pair of weaknesses. His treatment of labor reads like New Deal court history. "Confrontations between capital and labor were frequently bloody," says Lindsey. Then he cites cases that actually show that the violence was among *laborers*: "On May 3, 1884, labor trouble . . . sparked a confrontation between locked-out workmen and strikebreakers." The ingrained notion that workers and capitalists are opponents is an obstacle to a more liberal society, but unfortunately Lindsey gives it some support.

A second point is that much of the advancement by minorities before 1950 is underplayed. Thomas Sowell has shown that economic progress among blacks was substantially greater prior to the Great Society programs aimed at assisting them, but he isn't mentioned. This early progress strongly backs Lindsey's thesis that freedom works.

Readers, libertarian or otherwise, will find *The Age of Abundance* a pleasure to read. Almost every page contains at least one phrase that either amuses or enlightens—sometimes both. Entertaining anecdotes and witty writing pepper the book throughout. On a single page, for example, Marilyn Monroe, Hugh Hefner, *Peyton Place*, Brigitte Bardot, and "Itsy Bitsy Teenie Weenie Yellow Polka Dot Bikini" appear. Lindsey also weaves together disparate and seemingly unrelated events, such as the "Human Be-In" in Berkeley and the founding of Oral Roberts University in 1967. These and other memorable illustrations add to the considerable enjoyment of this book. FEE

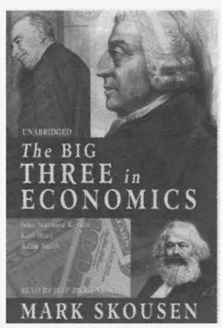
J. Wilson Mixon (jwmixon@bellsouth.net) is Dana Professor of Economics, Emeritus, Berry College.

The Big Three in Economics: Adam Smith, Karl Marx, and John Maynard Keynes

by Mark Skousen

M. E. Sharpe • 2007 • 256 pages • $25.95

Reviewed by David L. Littmann



It is a rare book that treats readers—even those who've never taken economics—to a comprehensive understanding of the forces and policies that ultimately determine prosperity and liberty for themselves and future generations. *The Big Three in Economics* by Mark Skousen accomplishes that, supplying essential historical perspective on the best-known names and evolutionary developments in economics.

This fascinating study focuses on the luminaries that have dominated economic conversations and debates since 1776. Adam Smith's eighteenth-century *Wealth of Nations* inquires into and documents the causes of wealth and prosperity. Karl Marx's nineteenth-century *Das Kapital* is a treatise on victimization by an economic system rooted in individual property rights and "natural liberty." It calls for centralization of authority in government that would facilitate redistribution of income and wealth. J.M. Keynes's twentieth-century *General Theory* outlines a framework to justify specific policy prescriptions for reestablishing systemic stability and maintaining economic security during business cycles.

Not only do Skousen's succinct examinations of the "Big Three" clarify the principles of economics for unsophisticated readers, they also furnish insights into and resonate marvelously with 2008's election-year polemics. The entire book crystallizes basic economic issues and delivers the intellectual tools to differentiate rhetoric from reality. For example, during 2008 alone, we've had the spectacle of one presidential candidate labeling the oil industry's barely average profit margins "egregious," while the other candidate (along with Congress and various regulatory bureaucracies) fingers so-called "oil speculators" for possible criminal investigations. Thanks to Skousen's research and dozens of prescient quotations, the curious investigator—layman or Ph.D. economist—can separate hyperbole and scapegoating from objective analysis.

Equally enlightening, Skousen surrounds Smith, Marx, and Keynes with their contemporary and historical disciples, who served to reinforce the message. An excellent example of this "reinforcement" effect, which helped Adam Smith's economic principles win the day, is the work of Jean-Baptiste Say.

Despite its title, the book isn't exclusively about Smith, Marx, and Keynes. It describes the influence of David Hume and the French Physiocrats on Adam Smith; the impact of Reverend Thomas Robert Malthus, David Ricardo, and Friedrich Engels on Marx; and the works of Alfred Marshall plus the English marginalist school, which provided the broad shoulders on which Keynes stood.

Skousen is at his best when he describes the lives of the three economists. For example, we learn the personal story of Marx and his life as a writer-agitator-theorist. At one point, Skousen quotes Marx's mother who complained: "If only Karl had made capital instead of writing about it!" Several documents from Marx's pen are so shocking they cannot be reproduced in this review.

By acquainting us with the dichotomy between what Marx envisioned and modeled versus how he behaved, Skousen's manuscript becomes a true guidebook. Beware hypocrisy, the author seems to say. Scrutinize those who expound elaborate economic theories and then violate them at their earliest convenience. Marx condemned stock-market trading yet indulged fully in the buying and selling of shares. While excoriating the capitalist system, he exploited the accumulated wealth of his in-laws, father, and closest associate.

An important spin-off from this three-century tour of economic thought is the growth of and respect for economics as a science. A particular strength of the book is how Skousen traces the continuity of economic challenges and problem-solving across the centuries. Readers will see how advances in economic thinking made it possible for later economists to resolve questions that befuddled Smith, Marx, and Keynes. Moreover, readers will be surprised by how many of today's populist political campaign slogans (such as "change" and "race to the bottom") were common parlance more than 150 years ago.

Of the many moments of delight and edification, I especially enjoyed Skousen's elegant construction of Milton Friedman's refutation of Keynesian theory and its so-called "revolution." Contributions largely from Friedman's Chicago School disciples and other Nobel laureates conclude the final chapter on a hopeful note. With overwhelming relevance to our nation's current economic challenges, Skousen recapitulates Adam Smith's fundamental theme underscoring the prescription for growth and material well-being of nations: "Peace, easy taxes, and a tolerable administration of justice." FEE

David Littmann (david_littmann@hotmail.com) is senior economist with the Mackinac Center for Public Policy.

Fuzzy Thinking

BY WALTER E. WILLIAMS

George Orwell warned, "But if thought corrupts language, language can also corrupt thought." That is the challenge—not allowing language and ill-defined terms to corrupt thought—that I face teaching economics to both graduate and undergraduate students. Terms that are widely used can have considerable emotional worth but little or no analytical value, ambiguous meaning, or unappreciated implications. In analytical usage precise, operational definitions must be found.

"Equality of opportunity" is a widely used term, but what does it mean? Sometimes I ask students if they are for or against equal opportunity. Most say they are for it. Then I ask how can they tell if equality of opportunity exists in a given activity. For example, does everyone in the class have an equal opportunity to earn an A? If not, how would they create equal opportunity? I ask them whether it is unfair when another is denied equal opportunity. Then I cite examples where I have denied others equal opportunity. For instance, not every woman was given an equal opportunity to marry me. I systematically discriminated against white and Asian women, handicapped women, women with criminal records, and women who did not bathe regularly. None of my criteria for setting up a long-term contractual arrangement would have met EEOC standards.

> Terms that are widely used can have considerable emotional worth but little or no analytical value, ambiguous meaning, or unappreciated implications.

Occasionally, a student might rejoin by saying marriage and earning an A are different—equality of opportunity mostly refers to employment or college admission. At that point I ask whether they think every employer should give them equal opportunity to be hired or every college give them equal opportunity to be admitted. Most often the reply is yes, at which point I ask whether they plan to give every employer equal opportunity to hire them or gave every college equal opportunity to admit them. Most often their answer is no; they plan to discriminate among employers, and they have already discriminated in choosing a college. I then ask them, if they're not going to give every employer an equal chance to hire them, why should every employer give them an equal chance to be hired?

Part of the justification for various labor-market restrictions, such as minimum-wage laws, collective-bargaining legislation, and work-hour legislation is to protect workers from the alleged superior bargaining power of employers. What is meant by superior bargaining power? Let's see. The president of George Mason University, where I am employed, has the power to tell me that the maximum wage he is willing to pay me is $20,000 a year. I have the power to tell him how many hours I am willing to work at $20,000 a year, namely, zero. So who has the superior bargaining power, me or the president? He has the power of price and I have the power of quantity. Alternatively, I have the power to tell him that I refuse to work for less than $500,000 a year. He has the power to decide how many hours he is willing to hire me at that price. Again, who has the superior bargaining power? I think it is impossible to say. What sets the minimum price the president pays for my labor services? If he wants my services, the minimum salary he can pay me is the salary I could earn at some other

Walter Williams is the John M. Olin Distinguished Professor of Economics at George Mason University.

university. What sets the maximum salary I could get from him is the salary some other economist will accept to do the same job that I am doing. Bargaining power is a vacuous concept. What truly protects the worker is the number of employers competing for his services. Similarly, what protects the employer is the number of employees competing for his job.

The Perils of Majority Rule

Another example of fuzzy thinking involves the word "democracy." So often we hear that our nation is a democracy. Somehow Americans have come to accept whatever our congressmen, state legislatures, or city council can muster a majority vote on. There is nothing benign about majority-rule decision-making. In fact, majority rule gives an aura of legitimacy to acts that would otherwise be deemed tyranny. Let's look at it while asking ourselves how many decisions in our daily lives would we like to be settled through majority rule.

How many people would like the majority to decide whether we have turkey or ham as the main course for Thanksgiving dinner? If turkey won the vote, it would be illegal to serve ham. What about the kind of car that we drive? If Lexus won the vote, it would be illegal to drive other cars. I am sure that if majority rule were the decision-making criteria in these and most other areas of our lives, we would deem it tyranny. Is it not the same when majority rule is used to dictate how we provide for our health care, how we prepare for retirement, or whether restaurants permit smoking, use trans fats, or serve foie gras?

In addition to majority rule being a form of tyranny, it is a major contributor to human conflict. The reason is that majority rule can be a zero-sum game. One group of people has their wishes satisfied at the expense of another group of people who do not have their wishes satisfied. In the Thanksgiving-dinner example, turkey lovers have their wishes satisfied at the expense of ham lovers. Ham lovers then have high incentives to enter into conflict with turkey lovers because they know that if turkey lovers win it will be at their expense. There would be no conflict if, as it is now, the decision on what to have for Thanksgiving dinner is made by individuals. In general, decision-making at the individual or market levels is conflict-reducing, while making decisions collectively or at the political level is conflict-enhancing.

> In general, decision-making at the individual or market levels is conflict-reducing, while making decisions collectively or at the political level is conflict-enhancing.

Our nation's founders had absolute disdain for democracy and majority rule. James Madison, in Federalist 10, said in a pure democracy, "[T]here is nothing to check the inducement to sacrifice the weaker party or the obnoxious individual." During the 1787 Constitutional Convention, Edmund Randolph said that "in tracing these evils to their origin every man had found it in the turbulence and follies of democracy." John Adams said, "Remember, democracy never lasts long. It soon wastes, exhausts, and murders itself. There was never a democracy yet that did not commit suicide." Chief Justice John Marshall added, "Between a balanced republic and a democracy, the difference is like that between order and chaos." The founders knew that a democracy would lead to the same kind of tyranny suffered under King George III. The term democracy appears in none of our founding documents. Their vision for us was a republic and limited government. FEE

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Prepared by Beth A. Hoffman, with the assistance of *Linda Newton*

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