

# THE FREEMAN

IDEAS ON LIBERTY

## Subprime Monetary Policy

by Gerald P. O'Driscoll, Jr.

Wartime Origins of Modern  
Income-Tax Withholding

by Robert Higgs

Murray Rothbard's  
Philosophy of Freedom

by David Gordon



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# THE FREEMAN

IDEAS ON LIBERTY

VOLUME 57, NO 9

NOVEMBER 2007

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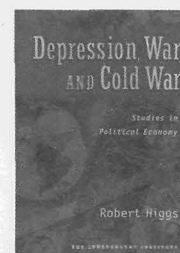
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# THE FREEMAN

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## Published by

The Foundation for Economic Education  
Irvington-on-Hudson, NY 10533  
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[www.fee.org](http://www.fee.org)

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*The Freeman* is published monthly, except for combined January-February and July-August issues. Views expressed by the authors do not necessarily reflect those of FEE's officers and trustees. To receive a sample copy, or to have *The Freeman* come regularly to your door, call 800-960-4333, or e-mail [bhoffman@fee.org](mailto:bhoffman@fee.org).

*The Freeman* is available on microfilm from University Microfilm International, 300 North Zeeb Road, Ann Arbor, MI 48106.

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## Perspective

# Pundit in Wonderland

In one of those boilerplate articles about the deteriorating American middle class, *Washington Post* columnist Harold Meyerson last September pointed out that a new Pew Research Center survey revealed that an increasing number of people think we live in a country divided into “haves” and “have-nots” and that more people now put themselves in the second group.

“In 1988, fully 59 percent identified themselves as haves and just 17 percent as have-nots. By 2001, the haves had dwindled to 52 percent and the have-nots had risen to 32 percent. This summer, just 45 percent of Americans called themselves haves, while 34 percent called themselves have-nots,” Meyerson writes.

He continued: “Harder times have come to left and right alike: The percentage of Republicans who call themselves haves has declined by 13 points since 1988; the percentage of Democratic haves has declined by 12 points.”

But curiously, while more people who identify with the two major political parties say their position is worsening, they nevertheless disagree over the divided-nation question. “The percentage of Democrats who say America is divided between haves and have-nots has risen by 31 points since 1988; the percentage of Republicans, by just 14 points,” Meyerson writes. “Indeed, though that 13-point decline in Republicans who call themselves haves has occurred entirely since they were asked that question in 2001, the percentage of Republicans who say we live in a have/have-not nation has actually shrunk by one point since 2001. (It had increased 15 points from 1988 to 2001.)”

Have and have-not what exactly? Meyerson has little to say about that rather obvious question beyond mentioning job stability and retirement security, as though being without those things is equivalent to being in poverty. Nevertheless, he offers an explanation for why Republicans are more reluctant to acknowledge this great division in our land: “Apparently, so great is Republicans’ loyalty to the Bush presidency that they’re willing to overlook their own experience. And, in many cases, to attribute the nation’s transformation solely to immigration, rather than to *the rise of a stateless laissez-faire capitalism* over which the American people wield less and less power” (emphasis added).

Excuse me? Stateless laissez faire? The U.S. economy—more precisely, the American population—has been laden with taxes, regulations, and the consequences of political privilege for decades—make that centuries. Corporations, rich farmers, and government contractors rake in billions of dollars every year. “National security” is the catch-all rationalization for all manner of subsidies. Trade restrictions, despite the heralded trade agreements, funnel tons of cash directly from consumers’ pockets to business coffers. Taxes, regulations, and patents, at most an inconvenience to incumbent corporate giants, stifle small and would-be competitors, depriving consumers and workers of new products and opportunities. Monetary central planners manipulate economic behavior and distort relative prices for political ends. Call it what you will, it’s not laissez faire.

Laissez faire would mean that people and goods could cross the borders unimpeded by Immigration and Customs Enforcement agents. Does Meyerson think that happens now? If it were happening, people from south of the border desperate to get here in search of a better life wouldn’t have to risk life to avoid detection, and unreadable multi-page trade agreements would be superfluous. But goods and people can’t cross borders merely in response to people’s wishes because government officials have arrogated the authority to say who and what may cross.

This intervention helps explain why people aren’t better off than they are. But this is a different issue from the one Meyerson raises. He talks as if more and more people really have become “have-nots.” This is hard to accept when it is empirically falsified just by walking down the street. Has it escaped his notice that people from virtually every socioeconomic group are carrying iPods and multi-function cell phones, wearing up-to-date clothing, and driving nice cars? At home they enjoy products their grandparents would have regarded as high luxuries—if they could have imagined them at all.

There is no clear divide between rich and “poor.” Rather, there’s a continuous spectrum of wealth and income in the United States, with even the poorest enjoying astounding affluence by historical and even current world standards. Truly freeing the market would

assure that anyone with ambition could share in that standard of living.

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The news is filled with trouble in the financial and housing markets because many people are unable to pay their subprime mortgages. Chalk it up to another failure of the Federal Reserve System, says Gerald O’Driscoll.

The United States has no free market in medical care, but it’s freer than anywhere else. So why do those international rankings place the country so far down the list? Jim Peron says the competition is rigged.

With the driver’s license transmogrifying into a national ID card, it’s hard to believe that you once didn’t need permission from the government to drive. Becky Akers guides us on a historical journey.

Beware the word “need.” Although it lacks precise meaning, it’s the trump card that justifies all sorts of government intrusions. Gary Galles explains.

Can the government intimidate a company into sabotaging its own employees’ defense against flimsy criminal charges? Roger Donway says: You bet it can.

The late Murray Rothbard was known as “Mr. Libertarian” because of his voluminous pro-freedom writing on economics, political philosophy, sociology, and history. How can one become acquainted with such a body of work? Start with David Gordon’s introduction in these pages.

In the columns this issue: Richard Ebeling marks the anniversary of the Bolshevik revolution. Donald Boudreaux spells out what government control of medical care would mean. Robert Higgs shows how we got tax withholding. John Stossel wonders how dead farmers can collect government subsidies. Charles Baird reports on progress in paycheck protection. And David Henderson, reading the claim that good health and pharmaceutical profits conflict, protests, “It Just Ain’t So!”

Our book reviewers have been chewing on tomes about twentieth-century totalitarians, U.S. history from the Great Depression on, justice, and property rights.

—Sheldon Richman  
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## The Soviet Chamber of Horrors: Reminders on the Ninetieth Anniversary of the Bolshevik Revolution

BY RICHARD M. EBELING



In 1842 the German poet Heinrich Heine warned that “Communism, though little discussed now and loitering in the hidden garrets on miserable straw pallets, is the dark hero destined for a great, if temporary, role in the modern tragedy. . . . Wild, gloomy times are roaring toward us. . . . The future smells of Russian leather, blood, godlessness, and many whippings. I should advise our grandchildren to be born with very thick skins on their backs.”

November 7 marks the ninetieth anniversary of the Russian Revolution and the beginning of that dark future that Heine sensed was coming 75 years before Lenin and his Bolsheviks came to power. Since the beginning of recorded history the state has attempted to control the economic activities of its subjects, as well as commanding their personal conduct. But nothing in modern history compared to the communist determination to mold man and society for an alleged paradise on earth.

What made this experiment in creating a new man in a new society so diabolical was precisely that many in the first generation of Bolshevik leaders truly believed in what they were doing. For example, Felix Dzerzhinsky, the founding head of the Soviet secret police, loved children and said he wanted to make a better world for all of them. To liberate Soviet society from its enemies and make that better world, he created the vast slave-labor system that became known as the Gulag. As part of his studies of government mass murders in the twentieth century, political scientist R. J. Rummel estimated that up to 64 million innocent, unarmed men, women, and children were killed in the Soviet Union between 1917 and 1986 in the name of “building socialism.”

Sixty-four million is so large a number that it is easy to lose sight of the inhumanity of murder and terror involved. The famous Russian sociologist Pitirim A. Sorokin (who went on to found the sociology department at Harvard University) was a young professor in Petrograd (later Leningrad and now St. Petersburg) during and following the Bolshevik Revolution. After he was expelled from Russia in 1922 as an “enemy of the people,” he came to America and published *Leaves from a Russian Diary* (1924), which contains the following entry from 1920:

The machine of the Red Terror works incessantly. Every day and every night, in Petrograd, Moscow, and all over the country the mountain of the dead grows higher. . . . Everywhere people are shot, mutilated, wiped out of existence. . . . Every night we hear the rattle of trucks bearing new victims. Every night we hear the rifle fire of execution, and often some of us hear from the ditches, where the bodies are flung, faint groans and cries of those who have not died under the guns. People living near these places begin to move away. They cannot sleep.

When Sorokin wrote those words the Soviet state was still in its infancy. As the decades went by, numerous histories and personal accounts were written about the “socialist experiment” by those who had either escaped or defected from the Soviet paradise. Only when the formerly secret archives of the Communist Party and the KGB were partly opened to researchers, just before

*Richard Ebeling (rebeling@fee.org) is the president of FEE.*

and then after the collapse of the Soviet Union in 1991, did a fuller and clearer picture come into view about the brutality of the regime.

Demitri Volkogonov, a Soviet general-turned-historian, gained access to many of the closed archives during the last years of the Soviet regime and wrote a biography of Stalin titled *Triumph and Tragedy* (1991). Volkogonov told an American correspondent:

I would come home from working in Stalin's archives, and I would be deeply shaken. I remember coming home after reading through the day of December 12, 1938. He signed thirty lists of death sentences that day, altogether about five thousand people, including many he knew personally, his friends. . . . This is not what shook me. It turned out that, after having signed these documents, he went to his personal theater that night and watched two movies, including *Happy Guys*, a popular comedy of the time. I simply could not understand how, after deciding the fate of several thousand lives, he could watch such a movie. But I was beginning to realize that morality plays no role for dictators. That's when I understood why my father was shot, why my mother died in exile, why millions of people died.

The Donskoi Monastery and Kalitnikovskiy Cemetery in Moscow served as a dumping ground for thousands of bodies. A Russian historian trying to preserve the memory of these evil times told David Remnick, author of *Lenin's Tomb* (1993): "In the purges, every dog in town came to [the cemetery]. That smell you smell now was three times as bad; blood was in the air."

### No End with Stalin

The Soviet nightmare did not disappear with Stalin's death in 1953; it remained at the heart of the system practically to the end. In the 1960s and 1970s Yuri Andropov was the head of the KGB (he later briefly served as general secretary of the Communist Party after Leonid Brezhnev died in 1982 until his own death

in 1984). He accepted a view developed by Soviet psychiatry that anyone who opposed the Marxist idea of scientific socialism was by definition mentally disturbed and needed to be "treated" in a psychiatric hospital. This was the fate of Alexei Nikitin, a coal miner who complained about the safety and health conditions in the mines of the U.S.S.R. He was found guilty of subversion and committed to a mental institution in Ukraine. They began using various drugs to bring him back to his socialist senses. His story was told by Kevin Klose in *Russia and the Russians* (1984):

Of all the drugs administered . . . to impose discipline, sulfazine was at the pinnacle of pain. . . . "People injected with sulfazine were groaning, sighing with pain, cursing the psychiatrists and Soviet power, cursing everything in their hearts," Alexei told us. . . . "If they torture you and break your arms, there is a certain specific pain and you somehow can stand it. But sulfazine is like a drill boring into your body that gets worse and worse until it's more than you can stand. . . . It is worse than torture, because sometimes torture may end. But this kind of torture may continue for years."

Nikitin endured this drug and several equally terrible ones for more than two years before he was finally released on the promise that he would no longer doubt or question the "correctness" of the Party line.

Twentieth-century socialism is an unending story of crushing tyranny and oceans of blood. As Russian mathematician and Soviet dissident Igor Shafarevich expressed it in *The Socialist Phenomenon* (1980), a history of socialism in theory and practice through the ages: "Most socialist doctrines and movements are literally saturated with the mood of death, catastrophe and destruction . . . . One could regard the death of mankind as the final result to which the development of socialism leads."

The 64 million killed during the nearly 75 years of the Soviet Union cry out with the truth of this conclusion.

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The Soviet nightmare did not disappear with Stalin's death in 1953; it remained at the heart of the system practically to the end.

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# Pharmaceutical Profits and Health Are Inconsistent? It Just Ain't So!

BY DAVID R. HENDERSON

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In a critical review of Richard Epstein's book *Overdose: How Excessive Government Regulation Stifles Pharmaceutical Innovation*, Arnold Relman (*The New Republic*, July 30) criticizes drug companies for their hypocrisy. Contrasting the companies' message to stockholders with their message to the larger world, he quotes Pfizer President Jeffrey Kindler's statement that his goal is "to create and sustain value for shareholders" and the company's advertising slogan, "Working for a healthier world." Relman writes, "To hear these firms tell it, making money is hardly of interest to them, because their primary concern is the public's welfare."

Although Relman has written about the drug industry for years, this statement shows a profound misunderstanding of how profits in that industry, or in any industry, work. Contrary to what Relman says, the main way for a drug company to make money is to promote the health of its customers.

But don't drug companies make money off our sickness? Yes, just as the food industry makes money off our hunger. But the food industry doesn't make money by keeping us hungry; it makes money by feeding us. Similarly, drug companies and other health-care providers make money not by keeping us sick, but by making us *well*.

One day in the fall of 1995 I got very sick quickly. I was unable to keep liquids in my body, and I lost almost ten pounds in less than 24 hours. My wife took me to the Community Hospital of the Monterey Peninsula. There I rested in a quiet private room in a clean, wonderfully comfortable bed, while an intravenous device

pumped about eight pounds of fluid into my body. I slept 22 of the next 24 hours. The bill for one day, slightly over \$2,000, was mostly covered by insurance. But had I been required to pay the whole amount out of my own pocket, I would have gladly done so. My doctor later told me that every cell in my body had been damaged and that, had I not gone to the hospital that evening, I might have died. For the next few months, whenever I drove by that hospital I cheered. The men and women working there didn't know me,

but spent their best energy making me well and, maybe, saving my life. However much they like helping people heal, they would not have been there if someone hadn't paid them. They made money off my sickness. Bless them.

The insight that sellers make money by giving customers what they want is not new. One of the most famous quotes in Adam Smith's *The Wealth of Nations* is his statement that it's not from the benevolence of the butcher, the baker, or the brewer that we expect

our dinner, but from their regard for their own self-interest. It's striking that more than two centuries after this insight became famous, a major political magazine that regards itself as a sophisticated commentator on the issues of the day publishes an article that parades such economic ignorance.

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I would like to live to age 100 and to be reasonably healthy up to that age. I would like my friends to do so also. That's unlikely, but what would make it more likely is for drug companies to figure out cures for the diseases that would otherwise kill many of us: heart disease, cancer, diabetes, Parkinson's, and Alzheimer's, to name a few. What motivates drug companies is the large revenue they can earn by developing drugs that cure diseases and save lives. Think about your family. I bet you can think of family members who were seriously ill who could have avoided illness had these innovations existed earlier. It's true of my family. My father had polio in both legs in 1944. My sister had polio in 1952. Unfortunately for them, the drug company Parke-Davis was unable to produce high-quality Salk vaccine until February 1954. Now we take for granted that we won't get polio—and that's thanks to a drug company that wanted to make money for its shareholders and thanks to some scientists who wanted to make money for themselves and their families.

Because of his distrust of the profit motive, Relman wants the government to continue regulating and, indeed, regulate more, the actions of drug companies. What is his argument for regulation? Nowhere in his lengthy review of Epstein's book on drug-industry regulation does Relman actually make an argument. Instead, he settles for quoting authority. Take Epstein's claim that Food and Drug Administration (FDA) regulations keep drugs off the market, sometimes for years and sometimes forever. Relman dismisses this argument rather than refuting it. Relman writes:

But this "logjam" [preventing new drugs] is pure conjecture, because there is nothing to support such a notion. There was once a problem with delays in reviewing and approving new drugs, but much has been done through legislation and administrative reforms at the FDA to expedite and to simplify the process of drug approval. The FDA now moves with greater alacrity than most analogous agencies in advanced countries.

Notice Relman's language. Epstein's idea is not an idea but a "notion." And Relman regards Epstein's idea as pure conjecture rather than something that has been backed up by logical argument and ample evidence. The argument for Epstein's claim is straightforward: all else equal, the more requirements the government puts in the way of drug development, the less development will occur. By starting, in 1962, to require drug companies to show that a drug is effective (the requirement that they be safe has existed since 1938), the FDA added to the delay between innovation and availability to consumers. The evidence is also ample. In 1974, University of Chicago economist Sam Peltzman estimated that the efficacy requirement added a minimum of two years to the drug-approval process. Later studies by economists and pharmacologists found similar results. (See [www.fda.gov/oc/ohrt/ohrt.html](http://www.fda.gov/oc/ohrt/ohrt.html).)

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The view that the profit motive and health of customers are antithetical is simply incorrect.

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### Who Decides?

Some might argue that it's worthwhile to delay drugs by years to make sure they're effective. But ask someone who's dying whether that's a worthwhile tradeoff.

Relman writes, "Almost everyone familiar with our health care system—including the leaders of the industry!—agrees that prescription drugs should be regulated." So let's get this straight. Relman seems to totally distrust the effect of the profit motive on drug companies' behavior. Somehow, though, we're not supposed to question one part of the drug companies' behavior, their support for regulation of their own industry. But why wouldn't they support regulation for the same reason airline executives supported regulation of their industry—to restrict competition? Relman ignores this question.

The view that the profit motive and health of customers are antithetical is simply incorrect. Drug companies look especially good when one considers the regulatory alternatives. Given a choice between trusting a government agency whose employees are paid the same whether or not they approve drugs or trusting a drug company that makes money by making me healthy, I would choose the latter.



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# Subprime Monetary Policy

BY GERALD P. O'DRISCOLL, JR.

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In recent years monetary policy has been conducted so as to create an expectation that the Federal Reserve will bail out investors when asset bubbles deflate. Investors have come to bank on the Fed's backing of risky ventures. The recent crisis in the subprime mortgage market is at least partly the outcome of this new approach to monetary policy. That crisis has already had widespread ramifications for homeowners and investors.

Government programs and policies often serve to insulate individuals from the full consequences of their actions. For instance, subsidized federal flood insurance leads individuals to build more homes in flood plains than would otherwise be the case. The public naturally feels sympathy for homeowners who are the victims of flooding, and supports more assistance for those caught up in these dreadful situations. The "help" often exacerbates the problem, however, by removing incentives for homeowners to rebuild on higher and drier land. The general public wonders why the catastrophes appear more frequently. Pundits ascribe them to global warming, and nature is blamed for the effects of manmade policy.

Since the 1930s the federal government has insured bank deposits. That scheme inherently reduced the vigilance of bank depositors toward their banks, removing constraints on risk-taking by the insured depository institutions. The situation became acute in the 1980s and 1990s, when unconstrained risk-taking by banks and thrift institutions led to a series of

banking and financial crises. Eventually the deposit-insurance system was reformed and banking put on a sounder basis. Now we are in need of a reform of monetary policy.

## Crisis in the Mortgage Market

Last February the popular press discovered subprime mortgage loans (see box) when two major originators of such loans, HSBC Holdings PLC and New Century Financial, disclosed increased loan loss provisions. HSBC is a globally diversified financial company. While it was a large lender in the market, the aggregate amount of its subprime loans was not a significant portion of its total portfolio.

New Century Financial fared much less well because of the concentration of its lending in this risky category. Its stock price collapsed after problems surfaced the previous February, and the company eventually declared bankruptcy.

Other lenders in the subprime market experienced difficulties. Fears of a housing collapse and even an economic recession grew as investors gauged the size and extent of the problem in the mortgage market.

The crisis was foreseen by many. For more than a year before the bust, bankers, analysts, and even regula-

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Government programs and policies often serve to insulate individuals from the full consequences of their actions.

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## A Glossary of Financial Terms

**Prime Mortgage** – Loans to the best borrowers who meet or exceed minimum requirements for credit scores, income, employment history, and other factors.

**Alt-A or Alt-Prime Mortgage** – An intermediate category of lending less precisely defined than either prime or subprime loans. Borrowers meet some but not all criteria for prime borrowers. Frequently the borrowers' income cannot be fully documented because they are self-employed professionals or small-business owners.

**Subprime Mortgage** – Loans made to borrowers who fail to meet minimum lending criteria. Information such as income may be undocumented. Lenders may provide 100 percent financing, which effectively makes the loan uncollateralized. Many loans involved “negative amortization” in which the loan payment was insuffi-

cient to cover principal or even all interest. Interest rates were often initially set below market and rose to market rates over time. Unless borrowers' incomes rose in the meantime, they might be unable to cover the higher payments. John Makin has described such loans as “household-sector junk bonds.”

**ABX Subprime Index** – An index tracking the cost to insure a group of BBB-minus-rated bonds backed by subprime mortgages. The index is a financial derivative and its price falls when the cost of insurance rises.

**Asset Bubble** – An increase in asset prices implying a rate of return that is unsustainable and in excess of what can be explained by underlying fundamentals. The assets can be real, such as housing and commodities, or financial, such as equities.

tors knew they had a mess in the making. As John Makin of the American Enterprise Institute observed, the lending practices in the subprime market were “shoddy and absurd.”

Lewis Ranieri, former chairman of Salomon Brothers, echoed those comments: “We’re not really sure what the guy’s income is and . . . we’re not sure what the house is worth. So you can understand why some of us become a little nervous.” Ranieri helped pioneer the bundling of mortgages into marketable securities (“securitization”), so he should know!

### Moral Hazard

The collapse of the subprime mortgage market is the latest in a series of financial bubbles whose existence reflects, at least in part, moral hazard in financial markets. Moral hazard is the outcome of explicit or implicit guarantees to investors. At one time, deposit insurance was a major culprit. Today, monetary policy is fostering moral hazard.

Moral hazard occurs when some action or policy

alters the behavior of individuals in a counterproductive way. Specifically, a policy intending to mitigate risk causes individuals instead to assume more risk. For example, a poorly designed policy insuring against fire could lead individuals to diminish resources devoted to fire prevention. In that case, the insurance would increase the probability of the insured risk occurring. (Of course, well-designed insurance policies should reduce risk. And in competitive markets, that is what normally happens.)

Earlier financial crises were the effects of deposit insurance and bank-closure policies that effectively insulated depositors and even other bank creditors from risk in the event of the failure of depository institutions. In an October 2002 speech to economists in New York, then-Fed Governor Ben Bernanke described the savings-and-loan crisis of the 1980s as “a situation . . . in which institutions can directly or indirectly take speculative positions using funds protected by the deposit insurance safety net—the classic ‘heads I win, tails you lose’ situation.” After an intellectual and political battle

of more than a decade, the deposit-insurance loophole was sealed.

To better understand moral hazard, consider the case of a gambler going to a casino. If he bears the losses, his bets will be constrained by that risk. If someone were to guarantee him against loss, but allow him to keep the profits, the gambler would have an incentive to make the riskiest possible bets. He gains all the profits but bears none of the losses. One might designate such a system as "casino capitalism." Current Fed policy has encouraged casino capitalism in the housing market.

Monetary policy can generate moral hazard if it is conducted so as to bail investors out of risky and otherwise ill-advised financial commitments. If investors come to expect that the policy will persist, they will deliberately take on additional risk without demanding commensurately higher returns. In effect, they will lend at the risk-free interest rate on risky projects, or at least at a lower rate than would otherwise be the case. Too much risky lending and investment will take place, and capital will be misallocated.

## Money and Prices

To simplify a complex theoretical issue, an ideal monetary policy is one that facilitates and does not distort economic decision-making by individuals. Market prices play a critical role in that process by signaling to everyone the relative scarcity of goods and urgency of ends.

Austrian economist and Nobel laureate in economics F. A. Hayek characterized the price system as a communications mechanism for transmitting information about economic values. By communicating that valuable information, the price system helps coordinate economic activities. In its simplest formulation, prices tend to bring about equality between supply and demand in each market.

As with any communication system, it is desirable to filter out "noise," extraneous signals that interfere with communication. Money is indispensable to price formation, but money can generate noise along with

information. The *ideal* monetary policy is one in which there is no noise, only valid price signals. The *best possible* monetary policy would maximize the signal-to-noise ratio.

Monetary noise comes about when policy changes the value of money. In economies on gold or silver standards, the discovery of new sources of the precious metal can set in motion forces leading to an expansion of the money supply and the depreciation in the value of money. In modern times, money is created by printing it, or through expansion of bank liabilities. In nearly all developed countries, the rate of that expansion is (or can be) controlled by central banks.

Changes in the value of money create monetary noise because investors and ordinary individuals mistake changes in money prices for changes in relative prices. For instance, during inflation prices will rise just to reflect the increase in money and not necessarily because there has been a shift in preferences.

Current monetary policy is much improved from the record of the late 1960s, 1970s, and early 1980s. That was the era of double-digit inflation and sky-high interest rates. In a December 2002 speech to the Economic Club of New York, then-Fed Chairman Alan Greenspan put monetary policy in historical context:

Although the gold standard could hardly be portrayed as having produced a period of price tranquility, it was the case that the price level in 1929 was not much different, on net, from what it had been in 1800. But, in the two decades following the abandonment of the gold standard in 1933, the consumer price index in the United States nearly doubled. And, in the four decades after that, prices quintupled. Monetary policy, unleashed from the constraint of domestic gold convertibility, had allowed a persistent overissuance of money. As recently as a decade ago, central bankers, having witnessed more than a half-century of chronic inflation, appeared to confirm that a fiat currency was inherently subject to excess.

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An ideal monetary policy is one that facilitates and does not distort economic decision-making by individuals.

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Some scholars have suggested that money influences not only the prices of consumer goods and wages, but also asset prices. They argue that money can work its mischief without showing up in consumer goods inflation. Widely used price indices, such as the consumer price index (CPI), do not include asset prices. A stable price index of consumer goods would thus not be a good measure of the value of money. Professor Charles Goodhart pointed to the two-decade experience of Japan, in which consumer prices were stable while asset prices fluctuated wildly. He asked rhetorically what the meaning of "inflation" is in such a context.

Goodhart argued that at least one category of assets figures so large in consumer purchases that it cannot be ignored: housing. Rental prices and housing prices do not always move in tandem. Home prices are affected by monetary policy in a number of ways, most notably through interest rates.

If asset prices are not incorporated into measures of inflation, their movements will not be action-forcing events for policymakers. Fed chairmen will wring their hands about "irrational exuberance," but will be powerless to do anything until the effects of asset-price changes are manifested in undesirable changes in *current* prices and output.

### The Greenspan Doctrine

The new moral hazard in financial markets has its source in what can be best described as the Greenspan Doctrine. It was clearly enunciated by Greenspan in his December 19, 2002, speech, in which he made an asymmetric argument leading to an asymmetric monetary policy. He argued that asset bubbles cannot be detected and monetary policy ought not in any case to be used to offset them. The collapse of bubbles can be detected, however, and monetary policy ought to be used to offset the fallout.

Two months earlier Ben Bernanke had made a similar argument. He endorsed the Greenspan Doctrine, arguing against the use of monetary policy to prevent asset bubbles: "First, the Fed cannot reliably identify

bubbles in asset prices. Second, even if it could identify bubbles, monetary policy is far too blunt a tool for effective use against them." Since Bernanke is now Fed chairman, it is reasonable for market participants to assume that the Greenspan Doctrine still governs current Fed policy.

### Wrong Question

The two men were surely asking and answering the wrong question. They were implicitly treating bubbles as solely the consequences of real shocks or disturbances. (An example of a real shock is a technological innovation leading to productivity gains and higher future expected profits in a sector.) They asked whether monetary policy should be used to offset the effects of real shocks and concluded that it should not. The latter is the correct answer to the question they each posed.

A different question would be whether monetary policy should be conducted so as to create or exacerbate asset bubbles, which would not have occurred or would have been milder absent the assumed monetary policy. The answer to that question is surely no. Consider Bernanke's apt characterization of moral hazard in the context of the deposit-insurance crisis: "When this moral hazard is present, credit flows rapidly into inelastically

supplied assets, such as real estate. Rapid appreciation is the result, until the inevitable albeit belated regulatory crackdown stops the flow of credit and leads to an asset-price crash."

Bernanke could have been talking about the subprime-mortgage market. That bubble and collapse cannot, however, be blamed on deposit insurance. First, deposit insurance is no longer systematically mispriced and banking supervision has improved. Second, the majority of mortgages are no longer made by insured depository institutions. Yet something generated the moral hazard that enabled shoddy underwriting of subprime mortgages to persist for years.

The Greenspan Doctrine helped create moral hazard in housing finance. The Fed announced that it will take no action against bubbles, but will act aggressively to offset the consequences of their collapse. In effect the

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central bank is promising at least a partial bailout of bad investments. The logic of the old deposit-insurance system is at work: policymakers should protect investors against losses, no matter their folly. Or, in Greenspan's own words: monetary policy should "mitigate the fallout [of an asset bubble] when it occurs and, hopefully, ease the transition to the next expansion."

In the present context, the "next expansion" could also be rendered as "the next asset bubble." If the Fed *promises* to "mitigate the fallout" from "irrational exuberance," then it is rational for investors to be exuberant. Investors may be at risk for some loss, as with a deductible on a conventional insurance policy, but losses are still being mitigated.

### Rate Cut in 2000

The Fed cut the Fed Funds rate sharply after the bursting of the stock market bubble in March 2000. In the eyes of many, the Fed cut rates too far and held them down too long, fueling not only a vigorous economic expansion but also the housing bubble. In his December 2002 speech, Greenspan was at pains to deflect any argument that the Fed was inflating a housing bubble. "To be sure," he acknowledged, mortgage debt was high relative to household income [remember the date] by historical norms. But "*low interest rates*" were keeping the servicing requirements of the mortgage debt manageable (emphasis added). "Moreover, owing to continued large gains in residential real estate values, equity in homes has continued to rise despite very large debt-financed extractions."

How wrong the Fed chairman was! If Greenspan was not worried about interest rates resetting, why should mortgage bankers and homeowners worry? It would have been reasonable to read into the chairman's musings an implicit guarantee of continued low rates. A homeowner is certainly entitled to bet his home on the

come if he wants. Should the central bank encourage such behavior?

### Monetary Policy for a Free Economy

In his 2002 speech to the Economic Club of New York, Greenspan spoke disapprovingly of a policy that permits prices to nearly double in two decades. At current CPI inflation rates, however, prices will double in less than three decades. If inflation were to rise to 3 percent and remain there, prices would double in 24 years. That is not much progress against inflation, and surely we can expect better.

In a vibrant market economy with technological innovation and ever-new profit opportunities, the monetary policy that maintains true price stability in consumer goods requires substantial monetary stimulus.

That stimulus will have a number of real consequences, including asset bubbles. These asset bubbles have real costs and involve misallocations of capital. For example, by the peak of the tech and telecom boom in March 2000, too much capital had been invested in high-tech companies and too little in "old-economy firms." Too much fiber-

optic cable was laid and too few miles of railroad track were laid.

By 2002 the Fed was worried about the possibility of price deflation and introduced a strong anti-deflationary bias. A tilt to stimulus was understandable at the time. A continued bias against deflation at any cost, however, will produce a continued bias upward in price inflation. The inflation rate begins at the positive number. With the bursting of each asset bubble and the fear of deflationary pressure, Fed policy must ease. The Greenspan Doctrine prescribes a stimulative overkill that begins the cycle anew. The Greenspan-era gains against inflation will then prove to be only temporary. His doctrine will be the death of his legacy, a legacy that already includes a housing bubble and its aftermath.




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At current CPI inflation rates, prices will double in less than three decades.

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# Ranking the U.S. Health-Care System

BY JIM PERON

It is curious that the United States ranked below Europe in the World Health Organization's 2000 *World Health Report*, which rated 191 countries' medical systems. In his documentary *Sicko*, socialist Michael Moore makes hay out of the fact that the United States placed 37th, behind even Morocco, Cyprus, and Costa Rica. This ranking is used to "prove" that state-controlled health care is superior to the "free market."

This ranking is curious because the actual life expectancy of the average American differs very little from that of the average European. At birth, average life expectancy in the European Union is 78.7. For the average American it is 78. And this doesn't adjust for factors that can affect the averages which are unrelated to health care, such as lifestyle choices, accident rates, crime rates, and immigration. Health isn't entirely about longevity but it certainly is a major component.

What is not mentioned by Moore, or others citing the WHO report, are the measures being used to rate the various countries and who is doing the measuring. There are many ways to nudge ratings in one direction or another that are not directly related to the actual item being measured.

For instance, one might produce a study on transportation. The purpose of transportation is to get people from where they are to where they wish to be. You

might rate how quickly people can move, how cheaply they can move relative to their income, how conveniently they can move, and how free they are to move.

You would think the United States would rate high in such a study. Americans tend to be wealthier than the rest of the world. There is widespread ownership of cars. Gasoline prices are lower than in most other countries. On average, the typical American can travel quicker, cheaper, and more conveniently than people in most parts of the world. But what if this index included other factors as well? For instance, if a major component was

the percentage of commuters who use public transportation, that would push the United States far down in the ranking. A larger percentage of the people in other countries have no other option but public transportation.

In 2000, when the report was issued, WHO was run by Gro Harlem Brundtland, a former prime minister of Norway and a socialist. She doesn't think the results of a health system alone are impor-

tant. Rather, she wants to know if the system is "fair." In introducing the WHO report she wrote that while the goal of a health system "is to improve and protect health," it also has "other intrinsic goals [that] are concerned with fairness in the way people pay for health care." She is clear about the ideological factors she



DR. GRO HARLEM BRUNDTLAND  
Gro Harlem Brundtland  
WHO

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thinks are important: “Where health and responsiveness are concerned, *achieving a high average level is not good enough*: the goals of a health system *must also include reducing inequalities*, in ways that improve the situation of the worst-off. In this report attainment in relation to these goals provides the basis for measuring the performance of health systems.”

True to her ideological roots, Brundtland prefers socialized medicine over private care. Drawing her first conclusion about what makes a good medical system, she declares: “Ultimate responsibility for the performance of a country’s health system lies with government. The careful and responsible management of the well-being of the population—stewardship—is the very essence of good government. The health of people is always a national priority: government responsibility for it is continuous and permanent.”

One WHO discussion paper states, regarding “fairness” in financing, “we consider only the distribution, not the level, as there is no consensus on what the level of health spending should be.” Equal results, not necessarily good results, are the focus.

When Moore or others refer to the WHO index as proof that private health care doesn’t work, they aren’t being totally honest because they fail to disclose that the index lowers the scores of systems that don’t satisfy socialist presumptions.

### A Second Rigged Study

The *New York Times* in August editorialized that American health care “lags well behind other advanced nations.” The newspaper relied in part on the WHO rankings as proof. For the rest, it relied on a more recent study by the Commonwealth Fund. But that study, which compared the United States to five other wealthy countries, has weaknesses similar to the WHO study.

The Commonwealth Fund marked down the United States partly because “All other major industrialized

nations provide universal health coverage, and most of them have comprehensive benefits packages with no cost-sharing by the patients.” Again the American system loses points because it doesn’t provide socialized medicine. And the *Times* neglected to note that “no cost-sharing” means the people have paid through taxes whether they receive the care or not.

### Non-Emergency Visits

The United States also was penalized because seeing a physician for non-emergency reasons is harder to do on nights and weekends than in the other five nations. The Fund said “many report having to wait six days or more for an appointment with their own doctors.”

The survey didn’t look at the treatment of serious conditions. Waiting weeks or months for chemotherapy is not held against a health-care system, but waiting a few days to have a check up is. Waiting time for “elective” surgery is counted (the United States was a close second to Germany), but waiting time for non-elective, serious surgery did not count, though that is precisely where socialist systems do the worst.

This issue is not unknown to the Commonwealth Fund. In 1999 it published *The Elderly’s Experiences with Health Care in Five Nations*, which found significant delays for “serious surgery.” Only 4 percent of the American seniors reported long waits for

serious surgery. The rate was 11 percent in Canada and 13 percent in Britain. For non-serious surgery the differences were more obvious: 7 percent in the United States, 40 percent in Canada, and 51 percent in Britain.

In the latest survey, the United States came in dead last for health “safety,” but many of the scores were only a few points apart. For instance, 15 percent of American patients said they “believed a medical mistake” had been made in their treatment within the last two years. Notice this is merely patient perception and nothing

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objective. But the best score was in Britain, where 12 percent said this.

The United States is also marked down because 23 percent of patients report delayed or incorrect results on medical tests they took. That is far worse than the best country, Germany, at 9 percent. But what constitutes a delay? If a result is expected in a week but takes two, that is a delay. But if it is expected in three weeks and arrives then, that isn't a delay. Thus what constitutes a delay depends on expectations, leading to counter-intuitive results.

The United States also lost credit because fewer Americans report having a regular doctor for five years or more. But Americans are more mobile than many other people. CNN reports that Americans move every five years on average. In comparison, Britain has a moving rate of 10 percent a year, or an average of once a decade. And 60 percent of those move about three miles.

### Freer to Change Doctors

Americans are also freer to change doctors if they wish. Britain requires patients to sign up with physicians, and once they do so, they are pretty much stuck unless they want to end up on the waiting list of another physician. Patients often have to wait to get on the books of a physician and only then can they be treated; that is, they wait to get on a wait list. This is true even for heart transplants. The inevitable waiting is a disincentive to change doctors.

Another measure used by the Commonwealth Fund is centralization of medical records. If a country has a system that allows doctors anywhere to tap into the patients' records, it is rated higher. The United States has no centralized database and so is rated lower. Many

Americans may prefer to have their records private and dispersed. When the Clinton plan was proposed in 1993, one of the rallying points that helped defeat it was the centralization of health records.

Out-of-pocket expenses were counted against a system as well. In socialized health care these expenses are zero or very low but are replaced with taxes. Taxes, however, don't lower a country's score because the care "is free."

Countries were also judged on the number of patient complaints. But different cultures have different attitudes toward complaining. Jeremy Laurance wrote in the *Belfast Telegraph* recently that the National Health Service needs "a healthy dose of American belligerence."

Finally, the United States is ranked last among the six nations surveyed in infant mortality. What is not discussed is that nations define infant mortality differently. Any infant, regardless of size or weight or premature status, who shows sign of life is counted as a live birth in the United States. Germany, which ranks number one in the Commonwealth Fund survey, doesn't count as a live birth any infant with a birth weight under 500 grams (one pound). How valuable is a comparison under those circumstances?

One could easily design a survey that would rank American health care high and other nations low. But this does not mean the American system is what it should be. Its successes and innovation can be attributed to the vestiges of freedom, but government has saddled the system with so much intervention that it is far from market oriented. Instead of worrying about irrelevant international rankings, we should be working toward freeing the medical market.



What is not discussed is that nations define infant mortality differently. How valuable is a comparison under those circumstances?

# So You Want Government-Supplied Health Care?

BY DONALD J. BOUDREAUX



Every summer my wife Karol and I enjoy the honor of lecturing at student seminars sponsored by the Institute for Economic Studies in Europe (IES-Europe). I offer whatever wisdom I can about economics and political science, while Karol shares her insights about law. (Other lecturers—including *Freeman* columnist Steve Davies and former FEE trustee Tom Palmer—cover history and philosophy.) Organized on a shoestring budget each year by the intrepid and talented Pierre Garello, who teaches economics at the University of Paul Cezanne in France, these annual seminars introduce (mostly eastern) European students to the foundations of classical-liberal thought. Karol and I always come away from those seminars impressed not only with the brainpower of the students, but with their hunger to learn more about free markets and other aspects of a society of free and responsible individuals.

The summer of 2007 was no exception. The seminar we participated in took place in July near Deva, Romania. This was our second trip to Romania; a 2005 IES-Europe seminar was held just outside the beautiful Transylvanian town of Cluj-Napoca. As in 2005, this year we began our Romanian adventure in Bucharest. We immediately noticed how much it has changed since 2005. Not only has Delta Airlines launched a direct flight there from New York (which we took), but near the Bucharest airport now stands a brand-new IKEA furniture store. Roads and driveways boast more new cars, and the downtown is blossoming with shiny new hotels, restaurants, and trendy retail stores.

Bucharest still has a long way to go. No one there is ever far from signs of Romania's communist past. Especially prominent are the hideously ugly, dilapidated concrete-block buildings. And most of the public parks are strewn with litter and obviously have enjoyed no landscaping in decades. But also unmistakable is the progress that Bucharest has made in the recent past—

and is still making.

Some of our Romanian friends note that this progress has a downside: horrible traffic. And, indeed, the traffic in Bucharest is nightmarish. Streets with more than two lanes are rare (and rarer still in parts of Romania outside of this capital city). And the roads are largely unkempt. They are typically narrow, poorly marked, and badly in need of resurfacing. So while private enterprise is hard at work supplying new cars, new eateries, and new retail outlets to Romanians, the government seems to be working at a snail's pace at supplying those amenities for which it takes responsibility.

## Back in the U.S.A.

When we landed at New York's JFK Airport on our return from Romania, Karol and I found ourselves with an unexpected windfall of extra time to reflect on our most recent experience in eastern Europe. Our connecting flight (back to our home near Washington, D.C.) was scheduled to leave JFK two hours after our flight from Bucharest landed. Fortunately, that flight landed about five minutes early. But then we proceeded to wait on the tarmac for more than 30 minutes before pulling up to the terminal to unload. The reason for this delay, the pilot explained, was that our gate was occupied.

Part of the blame for this delay, I suspect, belongs to Delta Airlines. For whatever reason, it couldn't load and prepare the plane departing JFK with sufficient dispatch. But another part of the blame, I'm sure, lies with the system Americans use to supply commercial passenger air transportation. All commercial airports in the United States are built and owned by government. This means that commercial airports are neither built nor operated in full accord with the profit motive. Political and bureaucratic incentives are the dominant forces in

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play to guide the construction and operation of these airports.

One result is too few gates for loading and unloading passengers at busy airports. With no profit motive guiding the building of such gates—or, more generally, with the price system not used to convey information about how many gates it would be best to supply—politicians and bureaucrats have too little incentive and information to ensure that the number of gates at airports is economically appropriate. So at busy airports such as JFK access to gates is too often allocated by waiting—such as the inordinate amount of time that our flight from Bucharest waited before it gained access to a gate.

Still, by the time we stepped off the plane into the terminal, we had just over an hour to catch our connecting flight. “We’ll make it,” I assured Karol. Because the flight from Bucharest was ten hours long, both of us recoiled at the thought of missing our flight from New York to Washington. Exhausted, we longed to sleep in our own bed.

Minutes later, though, we realized that we’d miss our flight to D.C. After walking down a long and dreary hallway to U.S. Passport Control, we and our fellow passengers were herded into the room where agents stood at their desks waiting to check our passports.

Despite the fact that JFK is one of the world’s busiest airports—despite the fact that summertime is the peak of the international travel season—despite the fact that other international flights were landing about the same time at that terminal—the U.S. Department of Homeland Security had a total of three agents employed that evening to examine the passports of U.S. citizens returning home. Three agents. That’s all. I didn’t count the number of agents assigned to inspect the passports of non-U.S. citizens, but I couldn’t help but notice that

most of the passport-control desks stood empty, mocking the many tired and frustrated passengers lined up and waiting in a slow-moving queue to have their passports stamped, clear customs, and then catch their connecting flights.

It took us 50 minutes to have our passports checked. By the time we claimed our luggage and cleared customs, we’d missed our flight.

### Government Health Care?

As I waited with increasing irritation in that line, I wondered why so many people want government to supply health care. Do these advocates of govern-

ment-supplied health care never fly internationally during the summer? When these people wait in long lines just to clear passport control and, in the process, notice the many empty desks that could be (but aren’t) occupied by additional agents, do these people not think that similar poor service might, perhaps, also characterize government-run health care? Do these champions of state-run health care never visit the post office?

The queues at passport control and the post office, along with the indifferent “service” typically rendered there, are too common not to be symptomatic of government supply. When

“customers” neither pay directly for what they receive nor have the option of either not paying for the product at all or of seeking an alternative supplier, suppliers have little motive to respond to the wishes of the people they are allegedly employed to serve.

So, for a good sense of what government-supplied health care would look like here, all you must do is to visit a foreign country (preferably during the summer), fly home on a late afternoon or early evening, and then watch government service in action. You’ll have plenty of time to observe.




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# Paving the Road to Serfdom

BY BECKY AKERS

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It's the stuff of nightmares and science fiction: a society so depersonalized and regimented that survival depends on producing the correct credentials. Sometimes it's a fingerprint or other biometric; more often it's a document. Without that totem there's no trading, no traveling, no transaction of any kind. A demand for "Papers, please" pesters people at every turn, whether they're buying a loaf of bread or enrolling a child in school. The citizen whose identification is lost, stolen, or—chillingly—revoked by the government becomes an instant pariah. He finds himself in a state of nature worse than any Hobbesian could imagine: not only is Everyman at war with him, but so is Everyman's technology.

The United States took a giant leap toward this harsh horror with the REAL ID Act. Passed in 2005, due to take effect next year, REAL ID is "vital to preventing foreign terrorists from hiding in plain sight while conducting their operations and planning attacks." Or so its sponsor, U.S. Rep. James Sensenbrenner (R-Wis.), wants us to believe. "By targeting terrorist travel, the Real ID will assist in our War on Terror efforts to disrupt terrorist operations and help secure our borders." But REAL ID actually targets—and hits—American drivers. The bill standardizes licenses so that whether they're issued in Alaska or Florida, they display the same data: name, date of birth, gender, a "digital photograph," the holder's signature, and home address ("permanent home address: no PO boxes; no exceptions," as Bill Scannell of unrealid.com puts it—even for spouses fleeing abusive

marriages and other vulnerable folks). It then forces each state to "provide electronic access to all other States to information contained in the motor vehicle database of the State." Translation: REAL ID enables bureaucrats in California or Connecticut to learn anything and everything about someone in the Carolinas. It also puts that data at the feds' fingertips, granting them and others unlimited access to information about us—and the unlimited power such knowledge brings.

Ominously, REAL ID also mandates that licenses

include "a common machine-readable technology, with defined minimum data elements." Who will "define" those "elements"? The Department of Homeland Security. Many experts think the department will require RFID (radio-frequency identification) chips as one "element." Manufacturers and warehouses control inventory with RFID because it uniquely identifies each product and tracks its movement. Substitute "person" for "product," and you'll understand

the state's enthusiasm for this technology.

REAL ID puts your driver's license on steroids, pumping it up to a national ID that must be flashed on authorities' demand. Intriguingly, Americans who scarcely mutter when taxes chomp a third of their paycheck, who submit without fuss to pat-downs at airports, who trust government to school their children, are outraged at REAL ID. So are state legislatures,

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REAL ID puts your driver's license on steroids, pumping it up to a national ID that must be flashed on authorities' demand.

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*Becky Akers (libertatem@aim.com) is a freelance writer who lives in Manhattan.*

though a cynic might attribute that to fear that the feds will steal some of their power over us. As I write, two states have passed laws rejecting REAL ID and 28 are deliberating about doing so. As you read, more have probably joined the revolt.

Meanwhile, despite their fury over REAL ID, Americans continue to ignore the dragon's teeth from which it sprouted: driver's licenses. The state has so habituated us to these permits that virtually no one questions them. Even champions of limited government who protest at having to seek permission before selling a product or buying a gun seldom object to licensing drivers. Most people see it as not only a legitimate function of government but a desirable one. Shouldn't the state protect us from the maniacs who would otherwise clog our roads?

But compelling citizens to ask permission before driving cars they've bought on roads they've paid for is lethal to liberty—and, often, to drivers. The state wants us to think its licensing protects us. Indeed, it would like us to commit the same error regarding its control of all things automotive, from road design and maintenance to enforcement of traffic laws to regulation of automobile design and manufacturing. But in all these areas, the state is a sponge, not a safety belt, sopping up all the money and power for miles. Protecting us is merely an excuse for controlling us. And, true to form, the authority that licensing handed the state spread like an oil slick. Having saturated our automotive lives, it's now seeping into more and more crannies that have nothing to do with cars.

### Licenses for the Asking

In the beginning states licensed anyone who paid a fee. They didn't test competence, vision, or anything else. Many contented themselves for years with this pay-off; decades sometimes passed before they also forced drivers to satisfy a bureaucrat that they could see and decipher the government's highway markings. Massachusetts and Missouri were both robbing drivers by 1903, but it wasn't until 1920 that "Massachusetts . . .

passed its first requirement for an examination of general operators" and "Missouri had no driver examination law until 1952," according to Carl Watner at [voluntaryist.com](http://voluntaryist.com). Nor were Massachusetts and Missouri alone in picking drivers' pockets. By 1909 "twelve states and the District of Columbia required all automobile drivers to obtain," that is, buy, licenses. These permits generally listed only the operator's "name, address, age, and the type of automobile he claimed to be competent to drive." No demonstration of skills was required, and drivers usually ordered licenses through the mail.

And so taxpayers whose money had bought and paved the roads now paid the government yet again so that it would allow them to use those roads. Prior to licensing, this arrangement was known as "highway robbery."

Regardless, the driver's competence—and the government's as well—didn't matter. In fact, the 12 states that extorted licensing fees from drivers in 1909 had issued "a combined total of 89,495 licenses . . . between January 1 and October 4[;] but only twelve applicants were rejected for incompetency or other reasons during this period—two in Rhode Island and ten in Vermont." No wonder Watner emphasizes, "*Our contemporary belief that drivers licenses were instituted to keep incompetent drivers*

*off the road is a false one.*"

Given the loot lifted from drivers, you might expect the push for licensing to have originated with government. But the blame actually belongs to the American Automobile Association (AAA), those seemingly innocuous folks who rescue stranded motorists and rate motels. AAA's website says the club was founded in 1902 by "1000 auto enthusiasts demanding a response to a lack of highways suitable for automobiles"—and we can all guess from whom they "demanded" this "response." Wikipedia adds that these "enthusiasts" were "typically wealthy." But their newfangled toy with its exhaust and loud engine irritated their neighbors, and they fought "widespread public disapproval of the automobile and its noise" at a time when there were roughly 17,000,000 horses versus 23,000 cars. How better to

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win this battle than to enlist the government's power and prestige? A certificate testifying to the state's approval should silence the spoilsports whose fastest stallions were eating the Model A's dust.

Departments of motor vehicles (DMVs) have come a long way since then with their eye charts, driving exams, and surly clerks. DMVs fool Americans into equating licensed driving with safe driving. But there's no proof behind that supposition because we don't know how many motorists neglect to ask permission. This invalidates statistics on who causes accidents. The AAA warns in "Unlicensed to Kill": "[The] methodology [of researchers who study licensing and safety] has limitations. . . . [I]t is hard to arrive at reliable findings for unlicensed drivers simply because so little is known about them." Belief that licensing makes safer drivers is just that.

So who needs research? Intuition alone tells us that licensing contributes to safer roads, doesn't it? Not necessarily. We won't debate the relationship driver's exams bear to the real world, nor whether an applicant is a better driver because he knows what behavior the law dictates when encountering a school bus on a divided highway or the exact moment at which headlights must legally shine. Even if the bureaucrats who devise these tests know what they're doing, licensing has unintended—and dangerous—consequences like all government fiats.

### More Likely to Flee the Scene

Unlicensed drivers who crash are likelier to run rather than stay to offer help or first-aid—or to receive it themselves: "Drivers with suspended, expired or revoked licenses may flee, rather than risk explaining to a police officer why they are driving," says a report at [deadlyroads.com](http://deadlyroads.com). "This is especially true in California, where some estimate as many as 1 million unlicensed drivers occupy that states [sic] highways. Many drivers with no license are illegal immigrants, who risk deportment [sic] with any law enforcement contact." Other

places complain of the same hazard. Sylvia Lazon of the University of Missouri-Columbia School of Law claims that "The large number of immigrants driving without a license is creating a public health hazard. . . . In rural Missouri, there is no public transportation and driving is a necessity, with or without a license. . . . The unintended consequence is that these drivers create public health hazards."

By law, unlicensed drivers cannot purchase insurance. Not only does that increase the pressure to flee an accident, but those who can't or don't flee are usually unable to pay for damages.

Government's greatest talent lies in destroying life and property, judging by its thousands of years of warfare. Why then do we expect it to save lives and property on the highway? It's no accident that driving has been considered inherently risky for as long as the state has monopolized the design of roadways and heavily regulated that of automobiles. Perhaps that's because the incentives that prompt private entrepreneurs to produce safe products go missing from government: "Bureaucrats do not lose money when the death rate rises," economist Walter Block notes in "Theories of Highway Safety." "Nor is the road manager rewarded, as in private enterprise, if a decline in accidents occurs." Those who design and maintain roads bear little responsibility for them; they

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Despite years of tragically high fatalities, government constantly shifts the blame for its lethal roadways. Accidents are the driver's fault, never the state's for stupidly designing and poorly maintaining roads.

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duck behind sovereign-immunity laws when their lack of initiative and innovation kills us. We don't know what free-market versions of roads and cars would look like, just as most Americans before the creation of UPS and Federal Express didn't realize how slow the Post Office was at delivering mail. But it's reasonable to suppose that if a completely free market prevailed in the automotive industry, we'd benefit from radical improvements.

For sure, no company could stay in business if its products were as lethal as the government's roads. Annual "traffic deaths" in the United States have hovered at roughly 42,000 for the last decade—about 22 deaths out

of every 100,000 users. (The number has very slightly declined since there are more licensed drivers now, from 23.21 deaths per 100,000 users in 1994 down to 21.54 per 100,000 in 2004, according to the “Fatality Analysis Reporting System Web-Based Encyclopedia” of the federal Department of Transportation.) That’s almost double the fatality rate of firearms. Many of these deaths occur when the victims are using cars and roads exactly as the government intends; they aren’t speeding nor have they bent an elbow except to turn the ignition key.

Yet despite years of tragically high fatalities, government constantly shifts the blame for its lethal roadways. Accidents are the driver’s fault, never the state’s for stupidly designing and poorly maintaining roads. Politicians reinforce this with incessant propaganda in favor of seat belts and against speeding, cell phones, and impaired driving. The advertising they buy with our taxes, the tickets and fines and prison sentences their enforcers dispense brainwash most victims into blaming themselves or their fellow drivers for mishaps. They sue each other, not the state, while those “at fault” pay fines to the very system that maimed them or killed the loved ones riding with them. Meanwhile, Americans continue forking over their funds and freedom to the DMV.

Those funds enormously enrich government, given the fees, taxes, and penalties it extracts in return for bestowing on us a privilege we already own as a right. Exactly how much is transferred from drivers to their masters can’t be determined. First, despite REAL ID’s zeal to consolidate information about us in a central database, government feels no compunction to return the courtesy: each state compiles its own records on what it charges drivers—and that varies in both amount and type from state to state. Secondly, reckoning the total by adding columns from the individual states is impossible because so many of the fees are obscured or never reported. Take just one category: traffic tickets. Municipalities often hide their income from this source lest their state demand a cut, so no one knows how much money tickets generate each

year. The National Motorists Association estimates that state and local governments rake in between \$3.75 and \$7.5 billion annually—and that excludes parking tickets. Now add fees for car registration, driver’s licenses, license plates, and title certificates, as well as taxes on automotive sales, insurance, gasoline, and parking, to say nothing of parking meters and tolls. (*Newsday* reports that New York City alone collected 126 million tolls solely for crossing to and from the island of Manhattan in 2006; these range from a couple of bucks for motorcycles to \$36 or more for a truck with 5 axles.) Then there are the quirky taxes some localities impose, such as New York’s “vehicle use tax.” We owe much of this to licensing; decades ago, it became the wedge enabling the state to drive a huge financial stake through our cars.

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Most states use the “privilege” of driving to control their residents, as parents do teens. Licenses can be revoked for a long list of infractions, many of which don’t pertain to driving.

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### Privileges Replace Rights

But licensing’s biggest hit-and-run is philosophical. Licensing replaces the common-law right of travel with a privilege that the state dispenses—and withdraws—at whim. It implies that we are silly children eager to drive without bothering to learn how; only the fatherly state saves us from automotive annihilation. That grants rulers enormous power over all our behavior, not just our driving.

Driving is merely another way to travel between Points A and B, as folks have for centuries. Philosophically, drivers should no more seek the state’s permission before hitting the road than did wagoners before shouting “Giddy-up!” Author Simson Garfinkel notes, “Our Founding Fathers never could have envisioned today’s driver’s license. It would have been inconceivable to [the] likes of Washington, Adams, and Jefferson that one day travel between a person’s home and work, or between nearby cities, in a carriage owned by that person, would be transformed from a right into a privilege to be granted and revoked at the pleasure of the state.”

Most states use the “privilege” of driving to control their residents, as parents do teens. Licenses can be revoked for a long list of infractions, many of which

don't pertain to driving. Minnesota will suspend a license for "providing false statements regarding insurance coverage" and "moving violations." But it also takes it away for such disobedience as "truancy," "underage consumption of alcohol" or even the "attempt to unlawfully purchase alcohol or tobacco," "failure to pay child support," and "out-of-state conviction." Ohio is more draconian. It doles out "points" for all the usual "traffic offenses" and then some, but there are plenty of nondriving capers that will send you to your room—for keeps. Ohio repeals its permission to drive for "dropping out of high school, drug-related offenses, unsatisfied civil judgments, delinquent, unruly, or habitual drug user (juveniles), failure to appear in court on a bond, liquor law violations, medical condition that would impair your driving ability [and who decides that?], tagged as a 'problem driver' in the National Driver Registry, insurance noncompliance, unresolved out-of-state ticket, out-of-state alcohol- or drug-related offenses." Cleveland, Columbus, and Coshocton may one day surpass New York as walkers' cities.

Ceding the state authority over our automotive lives

has a final consequence, this one likely intended: the Associated Press reports that "Traffic stops are the most frequent way police interact with the public, accounting for 41 percent of all contacts. An estimated 17.8 million drivers were stopped in 2005." The threat to freedom is so obvious that even a bureaucrat quoted by Carl Watner lamented it: "[T]he average adult American citizen [has] more direct dealings with government through licensing and regulation of the automobile than through any other single public activity. . . . [T]he incidence of arrest [for violation of motor vehicle laws] by armed police in the United States has undoubtedly reached the highest point for any civilization, democratic or totalitarian, in recorded history. While ours is assuredly a free society [this was written in 1968], it has nonetheless become commonplace for an American citizen to be arrested by an armed officer of the law. . . . One may well question whether the instincts of a free people will not one day be impaired by the habit of being arrested without protest."

Liberty never grants the state a license to license. Why have we?



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# Need and Public Policy: Handle with Care

BY GARY M. GALLES

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In public-policy debates the word most commonly invoked as the ace in the hole is “need.” However, “need” needs careful handling.

“Need” has the political advantage, but the logical disadvantage, of lacking a clear meaning. That allows it to be systematically abused to distort understanding and to reach desired conclusions that justify picking people’s pockets to pay for what someone else wants.

The concept has no universal meaning beyond “I want it, but I do not want to pay for it.” I learned this from my children, who wielded the word almost exclusively to extract benefits for themselves at parental expense. However, once we move beyond childhood’s focus on getting what is wanted by verbally manipulating parents, there is less reason to invoke “need.” In a world of voluntary market arrangements, one seldom uses the word (except when explaining why one did or planned to do something). If you really “needed” something, rather than saying so you would simply buy it or earn the resources to do so. Need would result not in mere complaining, but rather in actions that benefit others as well.

When public policy is discussed, though, “need” is resurrected as a weasel word by whoever wishes to avoid paying for what he wants—a return to the paternalism of childhood—and it should therefore raise a warning whenever it is used.

In that context “need” assumes away the conse-

quences of unavoidable scarcity. Scarcity exists for each of us, individually as well as for society, making tradeoffs imperative. And some of those tradeoffs involve choices among various “needs.” Therefore, calling something a need diverts attention from the actual choices faced.

“Need” makes people focus on the wrong margins of choice. For instance, that you need water to drink is

irrelevant to virtually every policy choice made about water. If the price of water rose, it would not be drinking water that people cut back on, but rather some of their many other, lesser-valued uses for water. (We all frequently treat water as nearly valueless because it’s so cheap, and we use it whenever the benefits exceed its very low price.) So discussing water in terms of need adds confusion, rather than insight, to decisions. And the same is true for innumerable other “needs.”

“Need” implies agreement on what and how extensive it is. However, needs are in the eye of the beholder, and their perceived extent varies dramatically from person to person.

(How much of X does one need?) When we don’t agree on its extent, using the word “need” masks that disagreement. It implies that the beneficiaries’ view is the relevant one, even when they are unwilling to offer enough to attract volunteers to supply their needs in the

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market. The often-different views of those forced to finance those needs are dismissed as irrelevant.


The idea implies that since people ought to have what they need, others have the responsibility to pay for such things if the ones in need cannot or will not do so. Unlike the cooperation in markets, this creates conflict whenever some of those “who can afford it” fail to volunteer to finance someone else’s need.

“Need” sometimes also implies that the impossible is possible. Saying we need to ensure that everyone on earth gets enough to eat is false. In all of human history, that has never been the case. Such assertions actually state desired situations—goals, not needs. And however much we may desire those goals, we often know no way to accomplish them, so they will be only distantly related to what is done in the name of achieving them. In such cases, “need” is used to argue that we must do *something*, ignoring that we will do little to achieve our goals or will even make things worse, especially in the long run as people respond to the perverse incentives produced by the policy.

In day-to-day conversation we are all sloppy with the word “need.” (For example, I need a shower.) That is fine as long as we know what we really mean. (I want to feel and smell clean.) The problem arises when we

transmute the word into a central premise to justify policies that violate other people’s rights and property. “Need” means “need in order to accomplish desire X.” The simple use of the word, however, does not mean others have the responsibility to accomplish X on someone else’s behalf. And it does not justify violating “Thou shall not steal” through the subterfuge of government.

Judging from what public-policy responses to “need” assertions have actually accomplished, they are just the rhetorical garnish necessary to justify using political coercion to plunder those who disagree about the extent of those needs. Those assertions don’t eliminate the alleged need, but they give more power to governments, which have never been known to be particularly responsible. That’s why the trillions of dollars spent on government programs addressing “needs” has accomplished so little.

The only thing that can ultimately help individuals meet their “needs” without infringing on others’ ability to meet their own is freeing them from the power others have to dictate to them, so they can make whatever voluntary arrangements that satisfy them. Government “solutions” that undermine voluntary arrangements cannot provide for our needs as well, no matter how many times we invoke the word as a smokescreen to justify coercing others. 

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The simple use of the word, however, does not mean others have the responsibility to accomplish X on someone else’s behalf.

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# A Democracy of Dunces?

BY SHELDON RICHMAN



When pro-free-market critics of democracy explain why laissez faire is not a winning election issue, they usually say that voters have no incentive to research economic policy because one vote won't sway the election and the expected payoff to any individual voter is infinitesimal. So, quite rationally, they vote on other bases. This "rational ignorance" leaves space for special interests to have their way, although if the voters paid attention they wouldn't put up with it. That explanation leads to the conclusion that democracy does not work because outcomes diverge from what people really want.

On the other hand, fans of democracy think that the rejection of laissez faire shows the system is working just fine.

In other words, both sides agree that voters are rational under the circumstances.

Which story is true? Maybe neither.

*The Myth of the Rational Voter: Why Democracies Choose Bad Policies*, by George Mason University economist Bryan Caplan, offers another explanation for why pro-market policies don't do well at the ballot box: Voters feel that interventionist policies are good policies and have no incentive to acquire information that would upset long-held preferences. Caplan writes, "In the naive public-interest view, democracy works because it does what voters want. In the view of most democracy skeptics, it fails because it does *not* do what voters want. In my view, democracy fails *because* it does what voters want."

For Caplan, the basic problem is that in a democracy, individuals don't pay the price for their preferences: "In economic jargon, democracy has a built-in *external-*

*ity*. An irrational voter does not hurt only himself. He also hurts everyone who is, as a result of his irrationality, more likely to live under misguided policies. Since most of the cost of voter irrationality is *external*—paid for by *other people*—why not indulge? If enough voters think this way, socially injurious policies win by popular demand."

Caplan says lots of people systematically (not randomly) make foolish choices at the ballot box about economic policies because they dogmatically believe those policies are good for the country. They don't understand the benefits of the free market and would resist the evidence. Moreover, "the price of ideological loyalty is close to zero. So we should *expect* people to 'sate' their demand for political delusion, to believe whatever makes them feel best."

Why do people have faith that bad economic policies are good? Because they incorporated biases into their worldview as they grew up and have no desire to examine them. Most people don't study economics, and most who do don't let their studies "corrupt" their biases. Market ideas are not intuitive. Caplan points out that while political scientists have been empirically documenting voters' systematic bias against free markets, economists have failed to assimilate the findings.

He breaks the bias down into four varieties: anti-market bias, antiforeign bias, make-work bias, and pessimistic bias. Antimarket bias refers to a "tendency to underestimate the economic benefits of the market mechanism." This comes from the counterintuitiveness of spontaneous order ("invisible hand"), win-win

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Why do people have faith that bad economic policies are good? Because they incorporated biases into their worldview as they grew up and have no desire to examine them.

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exchange, general good arising from self-interested action, the social role of profit, market pricing, and so on. I think this bias stems partly from the derogation of self-interest so common in religion and secular moral philosophy.

Antiforeign bias means underappreciation of the benefits of trading with people in other countries. This apparently results from some natural but unreasonable fear of foreigners, as well as a lack of understanding about the division of labor and law of comparative advantage. The result is a disposition against unconditional free trade.

The make-work bias, Caplan writes, is the “tendency to underestimate the economic benefits of conserving labor.” It shows up whenever something—technology, foreign competition, whatever—makes particular domestic jobs unnecessary.

The fact is that wants always exceed resources and labor. So when we can accomplish a task with fewer resources and less labor, the savings are available for new things we couldn’t afford yesterday. There’s no need to make work.

The final category of bias is the pessimistic bias—“a tendency to overestimate the severity of economic problems and underestimate the (recent) past, present, and future performance of the economy.” This is the prevalent belief that the present does not live up to some golden age. Of course, back in that supposed golden age, people were saying the same thing about some previous golden age, and so on, ad infinitum. Caplan notes that this belief has been attributed to the gradualness of progress (Smith) and to human nature (David

Hume). Regardless of the cause, the tendency toward pessimism seems resistant to facts. People think ours is an era of decline, while economists argue over whether the rate of *growth* is slowing or not.

Caplan’s thesis is more complex than I’ve indicated here, so interested readers should buy the book. I’ve not dealt with many questions, such as the role of special interests and whether government’s systematic historical intervention on behalf of business has tainted people’s

sense of what free markets and capitalism mean. But the core of the thesis strikes me as sound. It’s not what voters don’t know that brings them trouble, but what they know that isn’t so.

Caplan’s solution is to “rely more on private choice and the free market.” Good idea, though you’d have to get people to vote for that, so I’m not sure how effective it would be. Economic education for the public would also seem in order. But just straightforward teaching won’t be enough, for as Caplan elaborates, people hold fast to their errors through “emotional commitment.” He writes: “A good teacher could change some minds, but

the best teacher in the world would be lucky to convince half.” Dogma dies hard.

At the very least, this implies that the case for liberty must be pressed across the entire cultural front, especially in movies and novels where emotions as well as reason can be appealed to. We must find emotional commitments in the population that are consistent with freedom. Libertarian strategic wisdom may well begin with Jonathan Swift’s insight: “It is useless to attempt to reason a man out of a thing he was never reasoned into.”

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# The Obstruction of Justice Department

BY ROGER DONWAY

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**D**uring the last five years, U.S. government prosecutors have developed methods for stripping white-collar defendants—both corporate and individual—of their ability and willingness to mount a courtroom defense. One such method was pioneered during the case of Arthur Andersen, which formerly numbered among America's Big Five accounting firms. In March 2002 that firm was indicted on a single count of obstructing justice, and a *Wall Street Journal* story noted: "In the 212-year history of the U.S. financial markets, no major financial-services firm has ever survived a criminal indictment. Now, Arthur Andersen LLP will either make history—or be history." Of course, the firm did not survive, even though in 2005 the Supreme Court declared, unanimously, that the jury in the case had been wrongly instructed.

The destruction of Arthur Andersen provided a demonstration of one mighty prosecutorial weapon. Simply by indicting a financial-services company, the government could so undermine the firm's reputation that it would collapse. What a jury might say about its guilt or innocence did not matter because the company could not afford to go to trial. To survive, it had to stave off indictment by doing whatever prosecutors commanded.

And that led to a second weapon, one that could be used against individual white-collar suspects. In July 2002 President George W. Bush established the Corporate Fraud Task Force and appointed Deputy Attorney General Larry D. Thompson to head it. In January 2003

Thompson issued a memorandum urging "increased emphasis on and scrutiny of the authenticity of a corporation's cooperation." Specifically, Thompson said, one "factor to be weighed by the prosecutor is whether the corporation appears to be protecting its culpable employees and agents. Thus while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, [as] through the advancing of attorneys fees . . . may be considered by the prosecutor in weighing the extent and value of a corporation's cooperation."

This was very neat. A financial-services corporation must cooperate or die, and cooperation entailed not "supporting" employees who are somehow known to be culpable (prior to trial), for instance by advancing them the money they need to prove their innocence.

But surely, one might think, though the Thompson Memorandum opened up this potential for prosecutorial abuse, law-enforcement agents would never employ such powers to strip suspects of their best defense. Surely, prosecutors would say: "Let the adversarial system produce the truth." At any rate, surely, the sort of high-level prosecutors who carry out cases against top U.S. financial firms would not try to have defendants dragged into court financially bound and gagged.

For those who think so, the KPMG case is a revelation.

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## Criminalizing Tax Advice

The case against KPMG has roots going back to the mid-1990s when the company (another of the Big Five accounting firms) was selling financial strategies that allowed Americans to lessen their tax payments. In 2002 the IRS began issuing summonses to KPMG, requesting documents that the firm claimed were protected under existing rules of confidentiality. That disagreement led to a certain amount of back-and-forth tugging between the firm and the IRS. In November 2003, however, a Senate subcommittee publicized the IRS case by holding hearings on “tax shelter abuse” and focusing on KPMG. Accommodatingly, the firm sent several people to present a defense, including its deputy chairman and chief operating officer, Jeffrey Stein; Richard Smith, vice chairman in charge of the tax division; and Jeffrey Eischeid, a partner in the personal financial planning division. Predictably, the men were excoriated and insulted by antibusiness senators. At the same time, PBS’s *Frontline* helped feed the lynch-mob mentality by preparing an hour-long program on “bogus tax shelters,” also focusing on KPMG. The show featured former IRS Commissioner Charles Rossotti saying: “Anything that’s not being paid that should be paid, that’s basically what the honest taxpayer is making up,” as if “what should be paid” were somehow independent of a person’s financial transactions and as if federal spending were an unalterable sum that had to be raised one way or another.

All this negative publicity deeply troubled KPMG chairman and CEO Eugene O’Kelly. To deal with it he hired the law firm of Skadden Arps in January 2004, and particularly Robert S. Bennett, with the goal of setting KPMG on a course of public appeasement. Stein was allowed to “retire” with a three-year consulting contract, while Eischeid was placed on administrative leave and Smith was transferred out of the tax division.

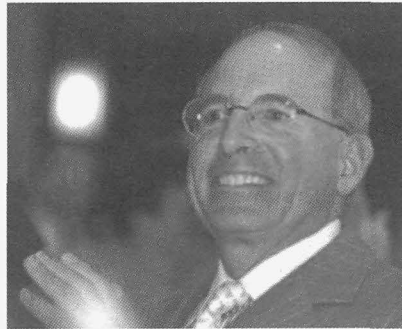
Such was the situation when the IRS made a criminal referral regarding KPMG to the Justice Department, which passed it along to the U.S. Attorney’s Office (USAO) for the Southern District of New York, where it was received on February 5, 2004. The USAO noti-

fied Skadden Arps, and a meeting was arranged for February 25. In the meantime, on February 9, the U.S. Attorney’s Office prepared “subject letters,” advising some 20 to 30 KPMG employees that they were persons “whose conduct is within the scope of [a] grand jury investigation.” These letters were hand-delivered, with most arriving before February 20.

Some months later the *Wall Street Journal* would editorialize that this entire approach to KPMG’s tax strategies was highly unusual and legally aggressive. Ordinarily “the IRS issues its point of view on a shelter, putting taxpayers who use it on notice. If the IRS then takes the taxpayer to court over the shelter, he has the chance to respond before a judge who makes a ruling and precedents are thus established.” But “in this case, the IRS called in the prosecutors first.

. . . No taxpayer has been brought to court over these shelters, and no judge has ruled on whether they ‘work,’ in the jargon of the tax-shelter business. . . . The KPMG case attempts to short-circuit the messy business of proving that a tax shelter is illegal by using the power of prosecution to target the tax advisers directly. . . . KPMG’s partners in this case believed they were selling

shelters that were entirely legal, and the underlying legality of those shelters has never been formally challenged. Yet the government has come down on those accountants and tax lawyers as if they belonged to the mob” (October 6, 2005). At the time, the *Journal’s* editorial writers did not know the half of it.



Charles Rossotti

## Betrayal

On February 18, in response to the government’s “subject letters,” KPMG CEO O’Kelly sent a memo to all partners assuring them that any “present or former members of the firm asked to appear will be represented by competent counsel at the firm’s expense.” At the February 25 meeting, however, lawyer Robert Bennett announced that KPMG’s object was to save the firm, not to protect individuals. In a reference to the fate of Arthur Andersen, he noted that an indictment of KPMG would result in the firm’s demise, leaving the country with only a Big Three in accounting. When

Bennett mentioned the subject of KPMG's paying legal fees, the government's lead attorney warned that "misconduct" should not be "rewarded." Another government attorney said that if the company was not legally bound to pay partners' fees but did, "we'll look at that under a microscope."

Following that meeting, KPMG abandoned its employees. It sent letters to targeted employees' lawyers, who were still being paid by the firm, saying that payments would cease if their clients were charged with criminal wrongdoing. In other words, contrary to what the firm's CEO had recently promised, there would be no money for legal defense. From that point on, government prosecutors pressed their advantage relentlessly. They notified KPMG whenever anyone had failed to comply with any of the government's demands, and KPMG duly notified that person's lawyer that his client had ten days to comply—after which legal fees would be terminated. When some people still failed to comply, they were fired. In the case of the firm's former deputy chairman, who had received a three-year consulting contract on being forced to leave the firm, KPMG suspended the contract unilaterally.

On August 29, 2005, in return for these and other actions, plus a fine of \$456 million, the Department of Justice entered into a "deferred prosecution agreement" with KPMG, which meant that the department would drop all charges against the firm on December 31, 2006—if it continued to cooperate. Having thus made sure that indicted KPMG employees would be nearly helpless, the government's prosecutors proceeded to charge eight of KPMG's former employees, and the firm cut off all payment of their legal expenses. In October a superseding indictment accused 17 former KPMG employees and two outsiders of conspiring to defraud the IRS. The case—involving millions of documents and hundreds of depositions—was expected to cost any defendant rash enough to go to trial some \$20 million.

### Fighting Back

In January 2006 the KPMG defendants (several already insolvent) moved to have the charges against them dismissed on the grounds that the government had improperly interfered with KPMG's advancement of money for their legal bills. In March the government

made its response, declaring that—Good Heavens!—it had no objection to KPMG's paying the defendants' legal expenses. Cutting them off had been entirely the firm's own decision, and the defendants (said the government) "cannot point to any evidence" indicating otherwise. In a letter to the court, a government attorney insisted that during the February 25 meeting "the Government did not instruct or request KPMG to implement that plan [not to pay legal fees] or to implement a contrary plan."

### Government Impeded Defense

In June 2006 the judge overseeing the case, Lewis A. Kaplan, found that "it had been the longstanding voluntary practice of KPMG to advance and pay legal fees, without a present cap or condition of cooperation with the government, for counsel for partners, principals, and employees of the firm." This arrangement was a private matter between employer and employee, the judge noted, but the government had very purposely interfered with the firm's practice, and that was not a private matter. The U.S. judicial system rests on the premise that partisan advocacy on both sides of a case is the best assurance that the guilty will be punished and the innocent go free. Despite that, government prosecutors had, on the basis of the Thompson Memorandum, leaned on KPMG to hamper its employees' ability to mount their best defenses. "KPMG refused to pay because the government held the proverbial gun to its head." Such behavior undermined "the proper function of the adversary process" and thus violated the defendants' Fifth Amendment right to a fair trial and Sixth Amendment right to the assistance of counsel. Moreover, during the Court's hearing on the issue, Judge Kaplan remarked, "[T]he government was economical with the truth." Its assertion that it had not engaged in coercion and bullying "could be justified only by tortured definitions of those terms." Kaplan observed that he had seen people convicted of making false statements for assertions less misleading than those the government's attorneys had offered him.

In an attempt to keep the trial on track, Kaplan ruled that, were the defendants to sue KPMG for their fees, he would listen to the claims. But KPMG challenged Judge Kaplan's right to haul it into court over the fee dispute,

and the Second Circuit Court of Appeals sided with KPMG in May 2007. At the same time, the appeals court noted: “Dismissal of an indictment for Fifth and Sixth Amendment violations is always an available remedy.”

Consequently, that was the course Judge Kaplan took. Six of the original defendants, he found, had not been wronged by government coercion. Two had never worked for KPMG; one had pled guilty; others were in various odd circumstances. But the remaining 13, he concluded, had indeed been deprived by the government of the ability they would have had to mount an adequate defense. And government attorneys had tried to deceive the Court into believing otherwise. That was intolerable. Last July 16, therefore, Judge Kaplan dismissed all charges against the 13. It was a drastic remedy, he acknowledged, but it was his only option.

### Obstructing Justice

Since that day, lawyers and bloggers have debated the correctness of Judge Kaplan’s ruling. Yes, say some, the Sixth Amendment guarantees people the right to “assistance of counsel,” and this has come to mean that people have a right to assistance of counsel

whether or not they can afford it. But that does not mean people have the right to legal representation that costs several million dollars.

Others say that misses the judge’s point, and I think they are correct. The defendants did not have a constitutional right to mount a multimillion-dollar defense, only a contractual right. But given that they had a contractual right, they also had a constitutional right that the government not plot to deprive them of such a defense.

On joining KPMG the defendants acquired a legitimate expectation that their legal expenses would be advanced should they get into trouble with the law as a result of their jobs. That contractual expectation was reinforced by the assurances that CEO O’Kelly gave immediately after he became aware of the U.S. Attor-

ney’s investigation. One thing only—the government’s threat to reduce KPMG to rubble—prompted the firm to deprive its partners and employees of what they rightly had coming. Such behavior, on the part of the government, “shocks the conscience,” said Judge Kaplan, who is not known as a civil libertarian. A prosecutor, he wrote, quoting a Supreme Court decision, “is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation is to govern impartially; and whose interest, therefore, in a criminal prosecution is not that it shall win but that justice shall be done.”

For a prosecutor to weaken his opponent by means other than argument is, literally if not legally, obstruction of justice. But that is what the Department of Justice has been doing, post-Enron.

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For a prosecutor to weaken his opponent by means other than argument is, literally if not legally, obstruction of justice.

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### Aftermath

Following its setback in Judge Kaplan’s courtroom, the Justice Department issued prosecutors new guidance through “the McNulty Memorandum,” named for a new deputy attorney general. According to a departmental press release, “[T]he new memorandum . . . instructs prosecutors that they cannot consider a corporation’s advancement of attorneys’ fees to employees when making a charging decision.” In addition, a *Wall Street Journal* story reports that “bills proposed in the House and Senate are seeking to rewrite sections of the McNulty memo to further restrict prosecutors” (July 18, 2007).

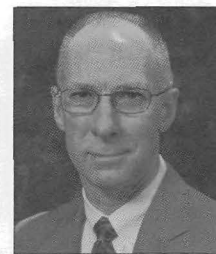
Truly, the KPMG case is the Justice Department’s Enron and should conclude with punishment meted out to those who abused their power and then lied about what they had done. But that will not happen. Indeed, the U.S. Attorney’s Office for the Southern District of New York has not even shown contrition for its actions. Quite the contrary: It is appealing Judge Kaplan’s dismissal of the charges against the 13 KPMG defendants and preparing to prosecute the remaining five.





# Wartime Origins of Modern Income-Tax Withholding

BY ROBERT HIGGS



Wars have always been the most important occasions for the introduction of new forms of taxation. At the outset of a war the state suddenly needs greatly increased revenues to pay for personnel and matériel to prosecute the war. Although governments typically increase the rates of existing explicit taxes and raise the rate of the hidden “inflation tax” by abruptly augmenting the money stock, these measures often prove insufficient, and other means must be devised to extract resources from the public quickly. One way to capture more revenue is to reduce tax evasion by seizing the people’s earnings before the earners ever lay hands on them. This procedure has come to be known as tax withholding at the source, or simply withholding.

Precedents for withholding U.S. taxes go back as far as the War Between the States, when the Treasury withheld taxes owed by federal employees under the income-tax law adopted in 1862 until an 1864 amendment exempted federal salaries from taxation. The war-spawned income-tax law was repealed in 1872, and an income-tax law enacted in 1894 was quickly declared unconstitutional (but not because it taxed wages and salaries). Immediately after ratification of the Sixteenth Amendment and passage of income-tax legislation in 1913, taxes were withheld at the source. This system provoked so much complaint from employers, however, that even the secretary of the treasury, William Gibbs McAdoo, recommended its elimination, and in 1917 Congress withdrew its authorization. After passage of the Social Security Act in 1935, the payroll taxes it authorized were collected at the source, but income taxes still were not.

Before World War II individuals who owed federal

tax on their income earned in a particular year paid the tax during the following year in quarterly installments. In those days relatively few people paid income taxes. As late as 1939 fewer than four million individual returns were filed, and the filers’ total tax bill came to less than \$1 billion, or less than 4 percent of their net taxable income. When so few people paid income tax and the amounts due in most cases were so small, the system of deferred payment imposed no great burden and gave rise to few taxpayer complaints.

Beginning in 1940, however, the tax burden increased enormously. As the government began to

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One way to capture more revenue is to reduce tax evasion by seizing the people’s earnings before the earners ever lay hands on them.

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mobilize for participation in a gigantic global war, its revenue demands grew apace. Federal spending burgeoned from \$9 billion in fiscal year 1940 to more than \$98 billion in fiscal year 1945. Although the greater part of this spending upsurge was financed by borrowing, huge increases in tax collections also took place. In 1945, 50 million individual income-tax returns were filed, and the filers owed more than \$19 billion, or almost 20 times the amount that Americans had coughed

up for this tax just five years earlier.

Milton Friedman was an economist at the Treasury during the early part of the war. In his 1998 memoirs, *Two Lucky People*, written with his wife Rose, he observed: “It was clear to all of us at the Treasury, as we set out to multiply the amount of revenue to be collected from the personal income tax, that it would be impossible to do so unless we could develop a system to collect the taxes as the income was earned, not a year later.”

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The main problem connected with switching to a “pay-as-you-go” system was that when the switch was made, the taxpayers would have to pay two years’ taxes in a single year—the amount due under the old system on the previous year’s earnings and the amount due under the new system on the current year’s earnings. Apart from the vociferous complaints such double-taxation was sure to produce, many people would simply be unable to make all the payments, especially when tax obligations were being increased drastically.

The transition problem sparked a great deal of debate in the government and among the public. Perhaps the leading proposal in 1942 came from Beardsley Ruml, the treasurer of R. H. Macy & Co., who was also the chairman of the Federal Reserve Bank of New York. Ruml proposed to “forgive” the previous year’s tax liability completely when the switch to the pay-as-you-go system was made. The Treasury objected to allowing such a great amount of “forgiveness” and proposed an alternative, less-forgiving design.

After more than a year of wrangling in the bureaucracy and in Congress, the Current Tax Payment Act was signed into law on June 9, 1943. It provided for a complicated partial-forgiveness transition. As Friedman described it, the law basically “canceled . . . one year’s tax obligations of \$50 or less and 75 percent of the required tax on the lower of 1942 or 1943 income, requiring the remaining 25 percent to be paid in two equal annual installments.” After the system became fully operational, employers withheld almost \$8 billion for income taxes in 1944 and more than \$10 billion in 1945.

Charlotte Twight, in a revealing chapter of her 2002 book, *Dependent on D.C.*, shows that during the extended debate that preceded passage of the withholding law in 1943, its proponents used various tactics to misrepresent its workings, its consequences, and the government’s reasons for seeking it. In particular, she documents that “the tax ‘cancellation’ was a sham and

was understood to be a sham by a significant number of government officials involved in its passage.”

The withholding system has remained in effect continuously ever since 1943, even though the war that prompted its creation ended 62 years ago, and the system’s perpetuation has contributed greatly to nourishing the postwar Leviathan state. As Twight says, “Withholding is the paramount administrative mechanism that since 1943 has enabled the federal government to collect, without significant protest, sufficient private resources to fund a vastly expanded welfare state.”

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The Treasury itself publicly acknowledges that wartime withholding not only “greatly eased the collection of the tax,” but “also greatly reduced the taxpayer’s awareness of the amount of tax being collected.”

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### Reduces Taxpayer Awareness

The Treasury itself publicly acknowledges, in a fact sheet on the history of the U.S. tax system posted at its website, that wartime withholding not only “greatly eased the collection of the tax,” but “also greatly reduced the taxpayer’s awareness of the amount of tax being collected, i.e.[,] it reduced the transparency of the tax, which made it easier to raise taxes in the future.” Some evidence: in 2005 more than 130 million individual income-tax forms were filed, yielding the federal government \$1,108 billion in revenue, and of that amount, \$787 billion, or 71 percent, came from withholding.

Friedman, who admitted being “one of the architects” of the Treasury’s proposal for a withholding system, correctly noted in his memoirs that the system “would have been introduced had I been involved or not.” Withholding was an essential element of the government’s wartime revenue grab. “At the time,” concluded Friedman, “we concentrated single-mindedly on promoting the war effort. We gave next to no consideration to any longer-run consequences. It never occurred to me at the time that I was helping to develop machinery that would make possible a government that I would come to criticize severely as too large, too intrusive, too destructive of freedom. Yet, that was precisely what I was doing.”



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# Murray Rothbard's Philosophy of Freedom

BY DAVID GORDON

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Murray Rothbard (1926–1995) based his political philosophy on a simple insight: slavery is wrong. Few, if any, would dare to challenge this obvious truth; but its implications are far reaching. It is Rothbard's singular merit to show that rejecting slavery leads inexorably to laissez-faire capitalism, unrestricted by the slightest government interference.

If we reject slavery, then are we not saying that each person owns his own body? Just what seems immoral about slavery is that some people, the slave owners, have the right to control the bodies of those under their domination. The owners can tell the slaves what to do and force them to obey if they refuse to comply.

One might at first think that this point has little relevance to modern society. The Thirteenth Amendment abolished slavery in the United States in 1865; surely it does not tell us very much of practical importance today to reiterate that slavery is wrong.

But are we not moving here too quickly? If the essence of slavery is forced labor for others, it is a very present reality today. When the government takes part of what you earn in taxes, it in effect forces you to labor for the state. Just as the slave does not get to keep what he produces but must surrender it to the master, so must the taxpayer give up part of what he makes to the government. One might object that someone can avoid being taxed by refusing to work, but this is hardly a

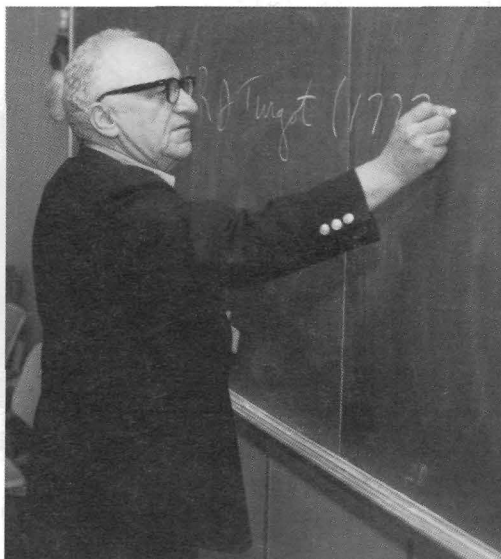
viable alternative. A slave system in which slaves could refuse to work, at the cost of not being supplied with any provisions, would hardly strike us as much of an improvement over simple slavery.

And the income tax is far from the only area in which the state acts as a slave master. In the United States, we do not now have a compulsory draft. But the government in the past enacted conscription laws that directly compelled people to serve in the armed forces, and may well enact such a law again. People serving in the military must of course follow orders, even if doing so will end their lives.

But once more, have we not moved too fast? Measures such as the income tax and conscription, however much they interfere with individual liberty, have been enacted by democratically chosen legislatures. How can we compare a democracy with a system in

which a master compels others to labor, regardless of what they want? In a democracy, an individual may not be able to do what he wants, but the majority of the people make the rules.

Rothbard argues that this circumstance leaves the essence of slavery unchanged. In a democracy, the majority acts as the slave master. So long as the individual cannot exercise full control over his own body, he



**Murray Rothbard**  
Mises Institute

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is to that extent a slave. The fact that he, along with his fellow slaves, has a share in determining what he will do still leaves him unfree. Democracy, in Rothbard's view, is a system in which each person owns a share of everyone else. It is merely a variant of slavery. The choice cannot be evaded: one must either favor self-ownership or slavery.

In many books and countless articles, Rothbard carried out his defense of self-ownership to its full logical, if controversial, conclusion. If you own your own labor, you cannot be compelled against your will to support the state, even if it confines its activities to protecting rights—other than, of course, the rights it violates by extorting resources through taxation. Further, people in a free society are at liberty to establish competing agencies to protect themselves: they need not confine protection to a monopoly agency.

So far the self-ownership principle has been presented as an obvious truth of common sense, but Rothbard was not content to leave matters at that. In arguing for self-ownership, Rothbard relies heavily on a point of fact. Everyone is in reality in control of his own will. If I obey another, I must always make the decision to do as he wishes; and the threat of violence on his part should I follow my own course leaves the situation unchanged. I must decide whether to accede to the threat.

But, one might object, even if Rothbard is correct that one cannot alienate the will, how does he get to the conclusion he wants? From the fact that the will cannot be alienated, how does the ethical judgment follow that each person ought to be recognized as a self-owner? Is Rothbard here committing the fallacy of deriving an “ought” from an “is”?

To our imagined objector, Rothbard would demur. He does indeed derive an “ought” from an “is,” but he would deny that he is guilty of any fallacy. He maintains that ethical principles follow from the nature of man.

How is this claim about ethics, which defies much of contemporary philosophical opinion, to be sustained? Rothbard found persuasive an argument advanced by Leo Strauss, a political philosopher with whom he was often at odds. Strauss appealed to ordinary language,

contending that the fact-value dichotomy of David Hume and his many successors was an artificial construction. Suppose, for example, that someone pushes you aside while you are waiting in line for a movie. Has he not acted rudely? The judgment that he has acted rudely is not a matter for subjective decision but is governed by objective criteria. But surely “rude” is a value term: what then has happened to the alleged dichotomy between fact and value? In the view favored by Rothbard and Strauss, value judgments are factual. If so, is it not also true—though this is much more controversial—that if human beings need certain things in order to flourish, this is at once a factual statement and a value judgment? So, at any rate, Rothbard maintained. (I am here offering only a sketch of his argument, not a full defense of it.)

Although his position is probably a minority one among contemporary analytical philosophers, several leading lights support it. The influential British philosopher Philippa Foot defends a view of the good quite similar to Rothbard's in her *Natural Goodness* (Oxford University Press, 2001). And even if, despite Rothbard's urgings, one continues to believe that an impassable gap separates fact and value, self-ownership remains a valid principle for anyone who rejects slavery.

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### Private Property

Once one accepts self-ownership the justification for private property soon follows. Each person owns his own labor. Does he not have a right, then, to what he produces by means of that labor? To deny this is to revert once more to slavery; it is to say that other people have the right to control your labor.

But once again, Rothbard must confront an objection: You may own your labor, but this does not suffice to justify property rights. People, after all, do not create the land that they wish to appropriate. But this point gives Rothbard little trouble. Land starts off originally unowned. Parcels of land do not come into the world with persons' names attached; and Rothbard firmly

rejects the Georgist contention that everyone owns all land collectively. "Some critics," he writes in his great treatise *Man, Economy, and State*, "especially the Henry Georgists, assert that, while a man or his assigns may be entitled to the produce of his own labor or anything exchanged for it, he is not entitled to an original, nature-given factor, a 'gift of nature.' For one man to be able to appropriate this gift is alleged to be an invasion of a common heritage that all men deserve to use equally. This is a self-contradictory position, however. A man cannot appropriate anything without the cooperation of original nature-given factors, if only as standing room. . . . Therefore, if property in land or other nature-given factors is to be denied man, he cannot obtain property in the fruits of his labor."

In Rothbard's view, then, one acquires property through "mixing one's labor" with unowned land, or by acquiring such property in gift or exchange from someone else. This doctrine of course comes from John Locke, though Rothbard embraces this principle of initial acquisition without Locke's numerous qualifications.

Rothbard displays great dialectical ingenuity in anticipating objections to his theory. One of the most important of these is that if one may acquire property through Lockean labor mixture, does this not unfairly bias matters in favor of the first possessor? Imagine a group of shipwrecked sailors swimming toward an uninhabited island. Does the first person to reach the island acquire all of it? Can he then refuse entry to his shipmates, unless they agree to work for him for bare subsistence wages?

Rothbard easily turns aside this difficulty, writing in *The Ethics of Liberty*, "Crusoe, landing upon a large island, may grandiosely trumpet to the winds his 'ownership' of the entire island. But in natural fact, he *owns* only the part that he settles and transforms into use. . . . The only requirement is that land be *once* put into use, and thus becomes the property of the one who has mixed his labor with, who imprinted the stamp of his personal energy upon, the land." (This book, along with *Power and Market*, is Rothbard's chief contribution to political philosophy.)

We may imagine another objection at this point. Suppose Rothbard has successfully rebutted the contention of Georgists and others that first possessors of land can in his system hold to ransom all others. Is not the system, however logical, of no practical relevance? Most property titles today do not stem by a clear line of transmission from a Lockean first owner. On the contrary, would we not find that many land titles go back to acts of violent dispossession? Would not an attempt to put Rothbard's system into practice quickly lead to a war of conflicting claims to property?

As usual, Rothbard has thought of the objection himself. He answers that the burden of proof lies on someone who disputes a land title. If he cannot make good his claim, the present possessor owns his land legitimately. If land titles cannot be traced back to an original act of legitimate appropriation, speculation about an original owner and his present descendants is idle.

But what if the objector *can* make good his claim? Then Rothbard is entirely prepared to follow out the implications of his system. Many landowners in Latin America and elsewhere would in a Rothbardian world find themselves in very much reduced circumstances: "[A] *truly* free market, a

truly libertarian society devoted to justice and property rights, can only be established there [in the underdeveloped world] by ending unjust feudal claims to property. But utilitarian economists, grounded on no ethical theory of property rights, can only fall back on defending whatever status quo happens to exist," Rothbard writes in *Ethics of Liberty*.

### Political Philosophy versus Ethics

Rothbard's book is in one sense mistitled. He sharply distinguishes political philosophy from ethics as a whole, and his book is addressed only to the former topic. When, for example, he deduces from the nonaggression axiom that people ought to be free to make any voluntary exchange they wish, his conclusion, like his premise, is part of political philosophy. He makes no attempt to argue that every voluntary exchange is morally desirable.

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Rothbard embraces this principle of initial acquisition without Locke's numerous qualifications.

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Indeed if Rothbard is right about political morality, it will often be immoral to attempt to prohibit immoral activity. This seeming paradox, instead of undermining morality, actually serves as an important means for its defense. One has only to glance at any period of history to see that the main violator of morality has been what Nietzsche called “that coldest of all cold monsters, the State.” Any doctrine, like Rothbard’s, that rigidly restricts the role of politics in the enforcement of morality can only be welcomed from the moral point of view.

### Are Ethics Necessary?

A substantial part of the book is devoted to Rothbard’s criticisms of other classical liberals, including Ludwig von Mises, F. A. Hayek, Isaiah Berlin, and in an especially noteworthy discussion, Robert Nozick.

Rothbard, as we have seen, goes to great efforts to justify a free society based on liberty and private property. But is this elaborate effort necessary to accomplish his goal? According to Rothbard’s great mentor, Mises, it was not. We can defend the free market, Mises said, without resort to any controversial assumptions about the nature of ethics. One can demonstrate, without making any value judgments, that interventionist measures such as minimum-wage laws fail to achieve the goals of their own advocates. If so, we have a value-free defense of resistance to such measures and the free market is vindicated. Does this not suffice?

Rothbard did not think so. As he points out, interventionist measures do help some people, albeit at the expense of others. Labor unions, for example, may raise the wages of their members, while causing others outside the union to lose their jobs. Why should one think that this result is, from the point of view of the union members, unsatisfactory? Contrary to Mises, then, interventionist measures do not always fail to attain the goals of their advocates. A value-free defense of the market cannot then stand by itself.

Rothbard first indicated his differences from Mises in an unpublished comment from around 1960 on Mises’s paper “Epistemological Relativism in the Sciences of Human Action.” Rothbard stated his essential criticism

forcefully: “But how can Mises know what motivates the statist? Suppose, for example, the price controller wants power, and doesn’t care if it creates shortages . . . (or is a nihilist and hates everyone, and wants to create shortages); suppose that someone who wants to confiscate the rich has a very high time preference and doesn’t care if the economy will be wrecked in twenty years. What then?”

But Rothbard did not altogether distance himself from Mises’s view that there can be a defense of the free market that rests on no controversial ethical assumptions. On the contrary, he extended it. In *Power and Market*, he contends that some types of interference with market can be rejected because they aim at a logically impossible goal. If a proposed ethical ideal cannot be realized, it must rationally be rejected. To accept this requires no adherence to a particular ethical view: it is a requirement of reason. As he wrote in *Man, Economy, and State*: “If an ethical goal can be shown to be self-contradictory and conceptually impossible of fulfillment, then the goal is clearly an absurd one and should be abandoned by all.”

One such impossible goal is equality of income. As he writes in *Power and Market*, “Income can never be equal. Income must be considered, of course, in real and not in money terms; otherwise there would be no true equality. . . . Since every individual is necessarily situated in a different space, every individual’s real income must differ from good to good and from person to person. There is no way to combine goods of different types, to measure some income ‘level,’ so it is meaningless to try to arrive at some sort of ‘equal’ level.”

Equality of opportunity fares no better. “Yet this, too, is as meaningless as the former concept. How can the New Yorker’s opportunity and the Indian’s opportunity to sail around Manhattan, or to swim the Ganges, be ‘equalized’? Man’s inevitable diversity of location effectively eliminates any possibility of equalizing ‘opportunity.’”

Rothbard’s ethical system, far more comprehensive than I have here been able to indicate, deserves the attention of everyone interested in political philosophy, as well as everyone who loves liberty.

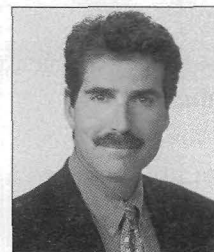
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A value-free defense  
of the market cannot  
then stand by itself.

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## Dead Men Farming

BY JOHN STOSSEL



**B**y now you've probably heard that a new Government Accountability Office (GAO) report states:

From 1999 through 2005, the USDA "paid \$1.1 billion in farm payments in the names of 172,801 deceased individuals. . . . 40 percent went to those who had been dead for three or more years, and 19 percent to those dead for seven or more years." One dead farmer got more than \$400,000 during those years.

And they say you can't take it with you.

Defending the USDA, the GAO adds, "The complex nature of some farming operations—such as entities embedded within other entities—can make it difficult for USDA to avoid making payments to deceased individuals."

Exactly. The agricultural section of the U.S. code is nearly 1,800 pages.

There's an easy way to avoid such absurdities: Abolish all farm subsidies.

Why are taxpayers forced to pay farmers \$25 billion a year? Sure, farmers face droughts and floods, but that's been true since Moses' day. They can't say they weren't put on notice that farming has risks. Running a restaurant or a software company entails risks, too, but we don't guarantee their continued operation. Those businesses and America are stronger for it.

Farm subsidies are popular with politicians because Big Agriculture lobbies hard, and many people believe that without subsidies we wouldn't have a reliable food supply.

But what an insane myth that is. As I wrote in *Myths, Lies, and Downright Stupidity*, most crops are not subsidized. Yet we have no shortages of fruits, vegetables, livestock, and poultry. America has plenty of peaches, plums, peas, green beans, etc., and farmers who grow those crops do fine. What makes wheat, cotton, corn, soybeans, and rice different?

Recently the *New York Times* reported that dairy farmers in New Zealand get along perfectly well without subsidies: "[E]ver since a liberal but free-market government swept to power in 1984 and essentially canceled handouts to farmers—something that just about every other government in an advanced industrial nation has considered both politically and economically impossible—agriculture here has never been the same. . . . [O]utput has soared."

Yet in America, our congressmen enact a 742-page farm bill that, among other things, includes 10 times more money than in 2002 for "specialty crops," including citrus, tomatoes, and melons, and an amendment to include goat meat in the mandatory Country of Origin Labeling Program.

An amendment that would have withheld subsidies from farmers with incomes of \$250,000 or more was rejected by the House.

The farm program is repulsive welfare for the rich. The average farmer earns much more than the average American.

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Most crops are not subsidized. Yet we have no shortages of fruits, vegetables, livestock, and poultry. America has plenty of peaches, plums, peas, green beans, etc., and farmers who grow those crops do fine. What makes wheat, cotton, corn, soybeans, and rice different?

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*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, recently released in paperback. Copyright 2007 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

And even rich nonfarmers have received subsidies—among them the late Ken Lay of Enron; Ted Turner, founder of CNN; my ABC colleague Sam Donaldson; and banker David Rockefeller.

And how absurd is this? “After handing out commodity subsidies that pay farmers to plant more crops,” Heritage Foundation senior fellow Bruce Riedl notes, “Washington then turns around and pays other farmers not to farm 40 million acres of cropland each year—the equivalent of idling every farm in Wisconsin, Michigan, Indiana and Ohio.”

It’s time we got over the myth that the government

helps the heroic family farm. Riedl points out that “federal farm policies specifically bypass family farmers. Subsidies are paid per acre, so the largest (and most profitable) agribusinesses automatically receive the biggest checks.”

Besides all the obvious ones, there’s another reason to end farm subsidies. They show us to be hypocrites. How can we preach free trade in talks with developing nations when we subsidize farmers who then dump their crop surpluses in poor countries and wreck their domestic farms?

Give me a break.



Coming in the December  
issue of **THE FREEMAN**  
IDEAS ON LIBERTY

**Casualties of the War on Poverty**

by Christopher Lingle

**Scratching By:**

**How Government Creates Poverty as We Know It**

by Charles Johnson

**Fear of Free Trade**

by Mark W. Hendrickson

**Immigration Control, Circa AD 175**

by Harold B. Jones, Jr.



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# Capital Letters

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## Were Missionaries Like Psychiatrists?

To the Editor:

People have misunderstood and maligned Christians for two millennia, but goodness, must Dr. Szasz compare us to coercive quacks? He writes in *The Freeman's* July/August 2007 issue: "Consider this parallel between psychiatry and missionary Christianity. The heathen savage does not suffer from lack of insight into the divinity of Jesus, does not lack theological help, and does not seek the services of missionaries. . . . the missionary tends to have contempt for the heathen . . . both [missionaries and psychiatrists] conceal their true sentiments behind a façade of caring and compassion. Each meddler believes that he is in possession of the 'truth,' . . ."

Such gross and gratuitous generalizations from a scholar of Dr. Szasz's insight are surprising. And the analogy is bizarre since his article proves that much of psychiatry relies on force; by contrast, Christianity insists that repentance and belief must come freely, without compulsion. This doesn't mean that all Christians always shun force, just as all libertarians don't perfectly uphold freedom. Both philosophies are also cursed with hypocrites who espouse our tenets for political or material gain. But just as we don't allow the Arnold Schwarzeneggers of the world to dissuade us from our devotion to freedom, so we realize that coercive "Christians" aren't what they claim to be, either. Christ Himself warned that "By their fruits, ye shall know them."

Meanwhile, Dr. Szasz's portrait of "missionary Christianity" is factually incorrect. Many "heathen savages" did indeed "suffer from lack of insight in the divinity of Jesus": without the Gospel and its condemnation of Satanic force, they hunted each other's heads, literally had their neighbors for dinner, sacrificed their children to assorted gods, enslaved the weak, and indulged in other atrocities that even the most libertine libertarian must disapprove. Folks all over the world are alive today because Christian "meddlers" took the Gospel to their forebears, persuading them to stop torturing and killing one another. Others flourish because they or their ancestors accepted all the "services" missionaries offered and then some: medical treatments, education in literacy

and improved agricultural techniques, etc. Missionaries helped during famines and other emergencies, too. In fact, "heathen savages" so avidly "seek the services of missionaries" that there's a term for it: "rice Christians," i.e., people who pretend an interest in Christ when they want free food or assistance.

Far from holding "the heathen" in contempt, Christians are called to love all men everywhere as Christ did. That means following the Golden Rule while confessing that God's grace, and not our own merit, enables us to believe the Gospel. Thousands of Christian missionaries over the centuries have humbly loved their fellow-man enough to die in his service. Dr. Szasz no doubt remembers one famous example: the murders of Jim Elliot and four friends at the hands of Ecuador's Auca Indians in 1956. These martyrs find their parallel in heroes like Nathan Hale, John Wilkes, and countless others, friends of freedom who also spoke truth to people who didn't want to hear it, who were imprisoned, exiled, and even executed for their message. Do we dismiss their courage and conviction as "meddling," too?

It is ironic that anyone affiliated with FEE would denigrate Christian proselytizing when that is precisely what FEE does on behalf of liberty. May God bless both Christian and libertarian missionaries as they enlighten this dark world.

—BECKY AKERS

New York, N.Y.

by e-mail

### **Thomas Szasz replies:**

I regret that Ms. Akers was offended by my column in the July/August issue of *The Freeman*. However, the offense she complains about was due to her misreading my essay as if it had been titled "Defining Christianity," instead of "Defining Psychiatry." She writes: "People have misunderstood and maligned Christians for two millennia, but goodness, must Dr. Szasz compare us to coercive quacks?"

I do not refer to, much less malign, Christians qua Christians. I compare coercive Christian missionaries (and, implicitly, all coercive missionaries) with coercive psychiatrists (not all psychiatrists). Nevertheless,

throughout her letter Ms. Akers systematically replaces my references to “coercive Christian missionaries” with “Christians.” Furthermore, when she does recognize the existence of “coercive ‘Christians,’” she declares them to be not (good?) Christians: “But just as we don’t allow the Arnold Schwarzeneggers of the world to dissuade us from our devotion to freedom, so we realize that coercive ‘Christians’ aren’t what they claim to be, either.”

That some (most) psychiatrists use coercion is a fact, acknowledged by psychiatrists. That some Christian missionaries used coercion is also a fact. Observing that “Missionaries helped during famines and other emergencies, too” is hardly a fair response to my carefully drafted essay.

Religion has always been and is still a sensitive subject. Doing evil in the name of religion is a supersensitive issue. Some recent remarks by Professor Charles Kimball, a respected historian and student of religion, are strikingly relevant to Ms. Akers’s letter. Kimball is professor of religion in the department of religion and professor of comparative religion in the divinity school at Wake Forest University in Winston-Salem, N.C.; holds the M. Div. degree from the Southern Baptist Theological Seminary; is an ordained Baptist minister; and has received his Th.D. from Harvard University in comparative religion. In his essay, “The Special Challenge for Missionary Religions: Can Missionary Efforts Be Pursued in Healthy, Constructive, and Noncoercive Ways?” Kimball writes:

It is no accident that the world’s two largest and most widespread religions include a missionary imperative. Unlike faithful Hindus, Jews, Taoists, and practitioners of Shinto, Christians and Muslims are expected to carry the Good News and the Islamic call to faith, respectively, to the far corners of the world. Although they disagree on the precise nature of God’s revelation and the paths to the ultimate goal, adherents in both traditions agree that their faith incorporates a missionary mandate. Far too often in both traditions, however, a narrow understanding of mission has combined with cultural imperialism and military power in ways that destroyed any witness to God’s love and mercy. Examples of missionary-related abuses abound. . . . When missionary zeal is informed by absolute truth claims defining who is “saved” and what is acceptable, the propagation of religion frequently includes sinister dimensions.

Can anyone observing the present alliance of the Church of Psychiatry with the Therapeutic State doubt that Kimball’s “missionary zeal” is the sentiment that motivates the modern missionary mental-health movement, the subject of my column?

## Does Inflation Have Only One Cause?

I appreciated and concurred with Howard Baetjer’s article, “Something Besides Money Growth Causes Inflation?” (July–August). However, when he writes that “a few economic phenomena have one and only one root origin. . . . One of these is inflation,” it seems somewhat absolute.

Allow me to employ a thought experiment, as he does. Suppose in a country half of its goods were destroyed (say, by a natural or manmade disaster). The populace would then have the same amount of money as before, but it would only purchase half as many goods. Consequently, the consumer would experience his loss as though there were inflation. That is, the price per average item would tend to double.


This is not to counter the sound points he makes, but only to question that they are absolute.

—ALLEN WEINGARTEN  
Monroe Township, N.J.

### *Howard Baetjer replies:*

I applaud Mr. Weingarten’s skepticism. My statement that there is only one cause of inflation *is* absolute, and I, too, am skeptical of single-cause explanations.

In this case I stand by it, however. Milton Friedman’s famous dictum that “inflation is always and everywhere a monetary phenomenon” refers to inflation as defined in the textbooks—a *continuing* rise in the price level, not a one-shot rise.

In the thought experiment, the price level would tend to double right after the disaster, as Mr. Weingarten says, but then it would stop rising. Such a sudden, discrete increase in the price level is not inflation as normally understood. In order for the price level to rise *continuously*, I can imagine no explanation other than a continuous increase in the money supply. Can you? 

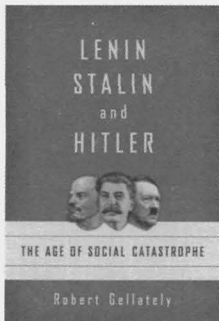
# Book Reviews

## Lenin, Stalin, and Hitler: The Age of Social Catastrophe

by Robert Gellately

Alfred A. Knopf • 2007 • 696 pages • \$35

Reviewed by Richard M. Ebeling



In his recent book, *Lenin, Stalin, and Hitler*, Florida State University historian Robert Gellately tries to explain the nature and the power of the Nazi and Soviet regimes in the first half of the twentieth century and how they were able to bring about so much death and destruction.

Gellately argues that Hitler's was a "dictatorship by consent." After the failure of his *putsch* in Munich in November 1923, Hitler decided that the only successful means to power was to use the democratic institutions of the Weimar Republic to end Germany's decadent bourgeois "Jewish" democracy. He appealed to and came to embody all the desires and frustrations of the German people. When Hitler spoke, he mesmerized huge crowds who heard him express their humiliation by the Treaty of Versailles, which had branded Germany as solely guilty for World War I and then burdened them with reparations to the victorious allies. He captured their yearning for restored national greatness and power and their fears of unemployment and poverty during the Great Depression.

Millions of Germans saw Hitler not as the imposer of a "new order" but the provider and guarantor of a bright and beautiful future after he came to power in January 1933. In the 1930s, before the outbreak of the war in 1939, Nazi thugs or state executioners killed hundreds of Germans and sent thousands more to concentration camps. The remainder of the population either passively or actively supported the new Germany. The Nazi meat grinder was set in motion to kill millions of "non-Aryans" after the war began—Jews, Gypsies, Poles, Russians, and "impure" Germans who were

either mentally or physically handicapped or "irredeemable" enemies of the state.

Gellately explains that there was nothing similarly consensual about the establishment and maintenance of the Soviet regime in the Old Russian Empire. Yes, there were many revolutionary idealists who willingly fought and killed to create a socialist utopia. Also, propaganda and indoctrination turned millions of Soviet subjects into supporters of the system. And there were countless Soviet sympathizers and fellow-travelers around the world who served as apologists and agents for the regime.

But Lenin and Stalin approached their task with a totally different mindset from Hitler's. Being good Marxists, they believed that while the end of capitalism was "inevitable," the masses were the victim of a bourgeois "false consciousness" imposed by the capitalist ruling class. The workers needed to be led and "reeducated" into being new socialist men. This required a revolutionary vanguard that would be ruthless in destroying the old order and creating the socialist utopia.

Gellately emphasizes that the Soviet nightmare was not the result of a "bad" Stalin who perverted the intentions of a "good" Lenin, which is how many historians have attempted to explain the Soviet experiment gone wrong. Gellately documents that the ideas of domestic terrorism, public executions, torture, and enslavement in what became the Gulag labor camp system were all Lenin's. He ordered the crushing of all opponents, including those on the "left," immediately ended any freedom of speech and the press, and nationalized the economy. He only stepped back from the totalitarian state in 1922 with his "New Economic Policy," which reprivatized small and medium-size industry and trade and allowed a limited market in agriculture, when he realized that he was faced with so many rebellions among peasants and workers that his government might be overthrown.


Stalin was the great intriguer and manipulator within the Communist Party after Lenin's death in 1924 and came to full power after 1928. But then he merely reinstated Lenin's radical vision with the collectivization of the land, the destruction of small private enterprise, and the imposition of five-year plans in 1929. Stalin also

imposed with a vengeance the totalitarian terror state Lenin had first implemented after the revolution of November 1917.

Gellately emphasizes aspects of Stalin's policies during World War II that have usually been ignored or only given limited attention. As the German army approached Moscow in October 1941, anti-Soviet graffiti began appearing on buildings, with workers grumbling that soon KGB agents would be getting what they had been meting out to them. Stalin ordered any citizens who fled the city without written orders to be stopped and if necessary shot—and dozens of men and women were killed for fleeing.

Stalin also ordered a scorched-earth policy as the German army advanced. But rather than just mandating the destruction of all facilities or supplies that the Germans might use after local residents had left, the order was to destroy everything and not allow the population to retreat. That policy left millions of people with nothing in the face of German occupation.

Furthermore, as the Soviets reoccupied territory in 1943 and 1944, Stalin commanded that close to a million people of various ethnic groups who were suspected of collaborating with the Germans be rounded up and sent to Siberia or Central Asia. Thousands died in transit or in exile. Most of these groups were not allowed to return home for more than ten years, until after Stalin's death.

Unfortunately, the collectivist tragedy of the twentieth century did not end with Hitler's and Stalin's deaths. It has continued, now, into the twenty-first century. 

*Richard Ebeling (rebeling@fee.org) is the president of FEE.*

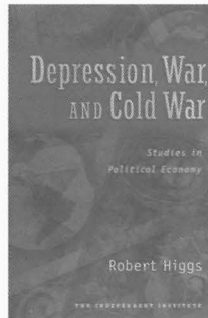


## Depression, War, and Cold War

by Robert Higgs

Independent Institute/Oxford University Press • 2006 • 219 pages • \$35

Reviewed by Burton Folsom, Jr.



In *Depression, War, and Cold War*, Robert Higgs has written a brief but superb account of the Great Depression, the economic effects of World War II, and America's proclivity for unnecessary military spending in the postwar period.

This iconoclastic book is a coherent collection of ten essays on the political economy of the federal government's welfare and warfare policies spanning the crucial decades of the twentieth century. When Higgs's essays are put side by side, they send a persuasive message that military spending, whatever its international political effects, did not rescue the country from the Great Depression, did not increase standards of living during World War II, and did not provide weapons at competitive prices after the war. Quite to the contrary, Higgs strongly advances the thesis that the federal government only managed to delay economic recovery and to squander wealth with its economic and military meddling.

Higgs writes that "the New Deal prolonged the Great Depression by creating an extraordinarily high degree of regime uncertainty in the minds of investors." That is to say, investors would have jump-started our stalled economy in the 1930s had it not been for the uncertainty caused by the policy spasms emanating from Washington. And in an attack on a durable myth, Higgs concludes that the war "itself" did not get the economy out of the Depression," because real private investment and real personal consumption sharply declined during the war. Stock market prices, for example, in 1944 were still below those of 1939 in real dollars.

What the war did do, Higgs argues, was to improve "economic expectations" that business would be allowed to invest freely after the war and that jobs would then be available. In part those higher expectations among businessmen reflected their relief that President Franklin Roosevelt had shifted from his attacks on

property rights during the 1930s to his all-too-eager willingness to let big business monopolize war contracts.

Meanwhile, the making of weapons created inefficiencies during and after the war. Higgs describes the rise of “cost-plus contracts,” which allowed large corporations to win risk-free contracts that guaranteed profits regardless of efficiency. Such contracts were rare before 1940, but then became common. Senator Harry Truman, chairman of the Senate’s Special Committee to Investigate the National Defense Program, wrote, “Huge fixed fees were offered by the government in much the same way that Santa Claus passes out gifts at a church Christmas party.”

After the war, vote-hungry congressmen worked with “pork hawks” to win military contracts—whether the country needed them or not. In several essays Higgs attacks the notion that the high military spending in the Cold War era was undertaken just as a defense against the Soviet threat.

To cite one instance, politicians in Pennsylvania persuaded the Department of Defense to buy 300,000 tons of costly anthracite coal to ship to military bases in Europe. At one point, since most of the coal was not needed, it was stockpiled locally—20 feet deep and covering 45 acres. As Rep. Dan Flood of Wilkes-Barre said, “I use all of these opportunities, advantages, seniority, and all this stuff for the purpose of helping whatever is left of the goddamn anthracite coal industry.”

Higgs has other painful stories. In the 1970s and 1980s, for example, Congress continued to fund the A-7 subsonic attack plane even though it had been surpassed by the F/A-18 and F-16 planes. The A-7 plane, however, was produced by a Dallas company and the Texas delegation insisted that funding to their Dallas friends be perpetuated.

Part of what makes Higgs’s book so valuable is that he tackles crucial economics topics that most economists and historians either neglect or do not understand.

Almost all historians, for example, take it for granted that federal spending in World War II lifted the submerged American economy out of the Depression tank. Few analyze that conclusion; they assert it as fact. And once such an alleged fact is established, the next step is to look at other ways the federal government, by various

kinds of subsidies and tinkering, can improve economic development. Higgs, however, by persuasively challenging the effects of military spending, calls into question the ability of federal spending to promote real growth in the U.S. economy.

In challenging the “military-industrial-congressional complex,” Higgs urges readers to focus not just on any benefits accruing to Dallas for making obsolescent planes or to Wilkes-Barre for stockpiling coal, but to focus on the flow of dollars out of the hands of hard-working taxpayers all over the country—all of whom could have invested or spent their money more wisely and beneficially.



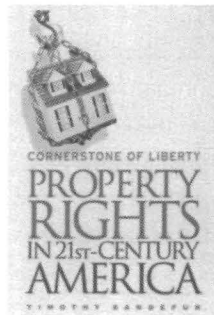
*Burton Folsom, Jr. (Burt.Folsom@hillsdale.edu) is Charles F. Kline Professor of History and Management at Hillsdale College. He is the author of The Myth of the Robber Barons, now in its fifth edition.*

### **Cornerstone of Liberty: Property Rights in 21st-Century America**

by Timothy Sandefur

Cato Institute • 2006 • 126 pages • \$19.95 hardcover;  
\$11.95 paperback

Reviewed by George C. Leef



Property rights are under constant and often successful attack in the United States. In 2007 the idea that an individual is entitled to own property and do with it as he pleases is fast becoming a relic of our quaint, long-forgotten past. One reason for that unhappy circumstance is that the general population has a dwindling understanding of the importance of property rights. The enemies of private property, who maintain that its use should be controlled for “the public good,” have made great inroads into the only ultimate defense that institution has—the belief in its essential rightness.

Timothy Sandefur, an attorney with the Pacific Legal Foundation who has fought in the trenches against the anti-property onslaught, sees the danger we face. To combat it he has written this excellent book. *The Cornerstone of Liberty* is a primer covering four crucial top-

ics: why private property is important and must be defended; the place of property rights under our Constitution; the weakened state of property rights today; and the author's views on the course of action we need to follow if property rights are to be restored. This is an important project, and Sandefur is to be congratulated for his good work.

His chapter "Why Property Rights Are Important" gets the book off to a blazing start. If readers don't understand the moral and economic reasons for insisting that the rights of individuals to acquire, use, and sell property as they choose must be protected, they certainly won't get much out of the book. Sandefur wants to see that they do. "Private property," he writes, "is one of humanity's great discoveries, like fire, DNA, or the scientific method. Like fire, property has the ability to release a kind of unseen power from nature. . . ." That is why societies that have defended property rights have rising standards of living and both social and technological progress. Conversely, the easier it becomes for people to deprive owners of their property, the less energy people put into productive work.

When societies regard private property with hostility, far from reaching some communitarian utopia, they not only get poorer but their people also lose the ability to live the lives they choose. Unless individuals can say, "This is mine and no one may take it," they're left at the mercy of those who are in control. Sandefur reminds us that people with the power to take property are usually anything but merciful—and not just in dictatorships, but also in "free" countries like the United States. Collectivists say that private ownership is based on greed, but what truly unleashes greed is the ability of some to take things from others.

To brilliant effect Sandefur quotes Frederick Douglass, who, after escaping from slavery, utterly delighted in his ability to earn money. Nothing contrasted so completely with the life he had known in slavery as to be able to call something *his own*.

In his next chapter, Sandefur demonstrates that the Constitution was meant to offer property owners a high degree of protection against the depredations of government. He quotes James Madison, who said that the proper role of government is the protection of property since "that alone is a *just* government which *impartially*

secures to every man whatever is his own." Unfortunately, legislators and judges have not been faithful to Madison's vision. Sandefur recounts the dismal history of the erosion of constitutional protection for property rights.

Next, Sandefur gives us the *really* bad news—the current state of the law. It is no exaggeration to say that every American has only a tenuous hold on his property (real estate and personal property) because the law is sympathetic to eminent domain and other forms of takings, such as civil asset forfeiture. The author's analysis of the recent *Kelo* decision on eminent domain is exemplary.

Can anything be done, or is the United States going to continue drifting away from property-rights protections? Sandefur is not a pessimist. He is a fighter and argues that it's possible that the American people could come to take property rights as seriously as they did two centuries ago. "Only learning, understanding, and teaching others about the principles of property rights and their importance . . . can solve the problems posed by eminent domain abuse, land-use regulations, and civil asset forfeiture laws," he writes.

Americans have been dozing while special-interest groups and their political lapdogs have done their dirty work in undermining private property, but there is hope that they are awakening. The outcry over the *Kelo* decision indicates that many Americans, for all the socialistic rhetoric they have heard, still believe that it's fundamentally wrong for government to take away private property.



George Leef ([georgeleef@aol.com](mailto:georgeleef@aol.com)) is book review editor of *The Freeman*.

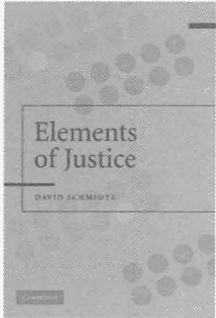


## Elements of Justice

by David Schmidtz

Cambridge University Press • 2006 • 243 pages • \$70.00  
hardcover; \$24.99 paperback

Reviewed by Aeon J. Skoble



There's a style of philosophical writing that is obscure, jargon-laden, and essentially inaccessible to nonspecialists. Happily, one of the most talented contemporary philosophers, David Schmidtz, is not a practitioner of that style. His newest book, *Elements of Justice*, is the kind of philosophy book that treats a serious topic in a thorough and well-organized way, while remaining entirely accessible to the intelligent lay reader. Schmidtz's topic is justice, something everyone ought to take an interest in, and his rigorous yet readable treatment of it will be of value for academics and non-academics alike.

Some say that justice is a matter of giving each person his due. But that isn't as helpful as it seems. It simply pushes the question back: how do we figure out what people are due? Schmidtz, who teaches philosophy at the University of Arizona, argues that while justice is primarily about what people are due, we cannot figure this out in an abstract way. Rather, we must look to the practical context in which the people are operating. Schmidtz breaks this down further, examining principles of desert, reciprocity, equality, and need. He sees those principles as the components of justice, and argues that if we can come to a better understanding of how *they* work, we will thereby come to a better understanding of what justice is.

"Different principles apply in different contexts," Schmidtz tells us. That simple yet frequently overlooked point is the key to parsing the sorts of conflicts that typically emerge in discussions about justice. For instance, some believe that need is the overriding principle, while others regard equality as paramount. On Schmidtz's view, this isn't the best way to think about it. Neither of these component principles, he says, can be the entirety of justice, although in particular contexts one may predominate. For example, need might be the predominant

principle in a child-parent context, determining what the children are due, whereas equality (in the sense of equality before the law) is what adult citizens are due. And even then, the context offers further refinements to our understanding.

Schmidtz makes an analogy between philosophical theories and maps: they're abstractions, first of all, but can nevertheless be accurate. Qualities like detail and scope are means to an end, not ends in themselves. Maps are only useful in context. (A map of the earth won't show you how to get to the train station in your town.) Similarly, a theory of justice can only apply its subsidiary principles in a context. Thus the way we talk about desert or reciprocity or need will depend on a consideration of that context. That is why, for instance, we might need to differentiate between a parent giving equal shares of his estate to his children and citizens in a republic being entitled to equal protection of the law, but not to equal shares of the total wealth in the society.

As he clarifies these principles and shows how justice depends on them (and on their being properly understood), Schmidtz defends several theses that speak to common myths and misconceptions. For example, he shows how liberalism isn't about atomistic isolation, a frequent canard of the communitarian left. And he shows how pluralism does not entail moral relativism, a perennial concern on the right. He devotes separate chapters to close examination of two of the best-known modern philosophers, John Rawls and Robert Nozick—the former chiefly associated with the welfare state and the latter a proponent of the minimal state.

Readers of *The Freeman* will be particularly interested in Schmidtz's arguments to the effect that the mere fact of income inequality does not necessitate forced redistribution by the state. He argues that the badness of poverty does not justify the disruption of a thriving economy. Rather, he maintains, to eliminate poverty we need a thriving economy coupled with a firm commitment to equality under law.

Of special note is the book's structure. It is divided into six major parts: What Is Justice?; How to Deserve; How to Reciprocate; Equal Respect and Equal Shares; Meditations on Need; and The Right to Distribute.

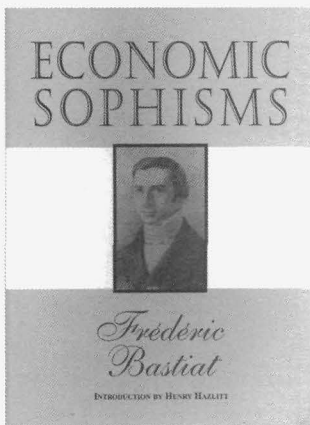
Each begins with an overview of a set of philosophical concerns, usually with a humorous anecdote to set the stage. The anecdotes are mostly little vignettes the humor of which derives from a misapplication of some ethical principle—for example, a judge issuing a ruling in which he lets someone off on a serious charge, on the grounds that he owes the person a favor: the virtue of reciprocity in action!

Within those parts are five or more chapters dealing with particular topics. For example, under “Equal Respect and Equal Shares,” Schmidtz examines the hot “equal pay for equal work” controversy. Each chapter

opens with a thesis statement, followed by a careful elaboration and ending with a set of puzzles for further reflection. These “further reflection” opportunities are doubly valuable: the active participation they require not only involves the reader in philosophical practice, but also demonstrates that even when a satisfactory answer to a problem is reached, there may be further questions. By combining clear argumentation with the asking of probing questions, Schmidtz embodies philosophy at its best.



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## Economic Sophisms

By Frédéric Bastiat

Introduction by Henry Hazlitt

Although written 150 years ago, Bastiat’s devastatingly accurate attacks on the illogical, self-serving arguments of protectionists remain both relevant and entertaining. Among the gems in *Sophisms* are “The Negative Railroad,” “Petition of the Candlemakers,” and “The Physiology of Plunder.”

Perhaps the best recommendation for *Sophisms* comes from renowned journalist and FEE founding trustee Henry Hazlitt. In his introduction to the book, Hazlitt declares:

*We could use more Bastiats today. We have, in fact, desperate need of them. But we do, thank Heaven, have Bastiat himself, . . . and the reader of these pages will not only still find them, as Cobden did, “as amusing as a novel,” but astonishingly modern, for the sophisms he answers are still making their appearance, in the same form and almost in the same words, in nearly every issue of today’s newspapers.*

Published by the Foundation for Economic Education

328 pages, paperback

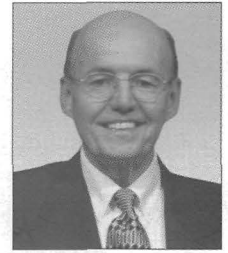
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# Paycheck Protection: Much Less Than Meets the Eye

BY CHARLES W. BAIRD



On June 14 the U.S. Supreme Court handed down its unanimous verdict in *Davenport v. Washington Education Association* (WEA) in which the Court upheld the constitutionality of the “paycheck protection” section of a Washington state campaign-finance-regulation initiative adopted in 1992 by 72 percent of the voters. That section required labor unions to get the permission of agency fee payers before the unions could spend any of those fees for election-related purposes. The decision was widely hailed as a significant victory for workers who are represented by unions but do not want their money used for union politicking. Alas, the victory was much less than meets the eye.

American union law denies individual workers the right to decide for themselves whether to be represented by a union on their jobs. Rather, under the doctrine of “exclusive representation,” if a majority of employees on a job want a union to represent them, all workers must submit to such representation whether they want it or not. They don’t have to be union members, but they must accept representation. Except in the 22 right-to-work (RTW) states, this often gives rise to “union security” arrangements in which every worker who is not a member of the union is forced to pay “agency fees” to the union in order to keep his job. Washington is not an RTW state.

In its 1977 *Abood* decision the Court said, on First Amendment grounds, that agency fee payers in government employment do not have to pay for a union’s political and ideological advocacy. In its 1986 *Hudson* decision the Court set out minimal procedural rules unions must follow to enforce the *Abood* decision. The minimal rule at stake in the *Davenport* case was that

agency fee payers must be given a chance to opt out of paying any fees unions would use for political purposes. If they opted out, fee payers would get a refund of a portion of the agency fees. If they said nothing, unions could use their agency fees for politics.

The paycheck-protection provision of Washington’s 1992 campaign-finance law went beyond *Hudson*’s opt-out rule. It said that before a union could use any agency fees for politics, the fee payers must first consent. In other words, they would have to opt *in*. Silence was now taken as denial of permission to use the fees for politics.

The WEA ignored the opt-in rule of the initiative until, in 2000, the Evergreen Freedom Foundation filed a complaint with then-attorney general Christine Gregoire, who proceeded to launch the litigation that culminated in the Court’s *Davenport* ruling. Along the way six of the justices on the Washington state Supreme Court declared the paycheck-protection measure unconstitutional because it placed too much of a burden on the WEA’s right of

free political speech. The state court said the Supreme Court’s earlier agency-fee jurisprudence (*Abood*, *Hudson*, among others) balanced the constitutional right of unions to receive money from those they represent in order to participate in political speech against the constitutional rights of agency fee payers not to be coerced into funding political speech with which they disagree. The paycheck protection provision, the state court said, broke that balance.

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In its 1977 *Abood* decision the Court said, on First Amendment grounds, that agency fee payers in government employment do not have to pay for a union’s political and ideological advocacy.

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Justice Antonin Scalia, who wrote the *Davenport* decision, quickly dispensed with that bit of sophistry: “The agency-fee cases did not balance constitutional rights in such a manner because unions have no constitutional entitlement to nonmember employees’ fees.” First Amendment rights inhere in individuals, not groups. Scalia also wrote, “It is undeniably unusual for a government agency to give a private entity the power to tax government employees.” Only unions representing government employees have that privilege, and there is nothing in the Constitution that prohibits government from regulating that privilege. Governments can revoke that privilege altogether (as in the RTW states), and they can restrict it, as Washington voters did, by implementing an opt-in rule.

Since the 1950s the National Right to Work Committee has tried to enact RTW laws in as many states as possible. The Committee is now promoting a national RTW law which would eliminate the collection of forced union dues throughout the country. Many RTW supporters have regarded paycheck-protection legislation as, at best, a diversion of resources, effort, and attention from the more fundamental RTW effort. Nevertheless, the National Right to Work Legal Defense Foundation participated in the *Davenport* litigation against the WEA. It did so because if the state Supreme Court’s ruling that unions have a constitutional right to receive money from nonmembers to fund the unions’ political speech had been allowed to stand, the whole RTW principle would have been in legal jeopardy.

The main significance of *Davenport* is that it is now clear the unions have no constitutional right to seize money from nonmembers. However, except in the RTW states, unions continue to have a statutory privilege to do so. This is the “unusual” legal, but immoral privilege of “a private entity . . . to tax government [and private] employees” Justice Scalia alluded to. That egregious grant of tax powers to unions is what ought to be addressed. Paycheck protection accepts what is evil and merely attempts to make it less burdensome. This is better than doing nothing, but it is very little indeed.

Because of *Davenport*, other state governments

and/or voters may be encouraged to enact paycheck-protection legislation. However, if they do so I do not think workers who want to be union-free will be much better off than they are now. Notwithstanding *Davenport*, the opt-in provision of paycheck protection is no longer available to Washington state employees. In anticipation of the Court’s decision, Washington’s legislature and Governor Christine Gregoire simply repealed the opt-in rule. The Court said that states may impose opt-in rules, but it did not say states must do so. Oh, yes: The legislation that removed the opt-in rule included an emergency clause that makes it impossible for Washington voters to restore paycheck protection by another referendum. Such is the union-based politics of plunder.

### Unenforceable Protection

Various paycheck protection measures have been enacted in several states. Even in those cases where politicians do not conspire with unions to repeal or amend them, they are practically unenforceable. The paycheck-protection principle is that agency fee payers should not be forced to pay for union politicking. All it takes is a bit of creative accounting and imaginative tinkering with defini-

tions for unions to evade the law. For example, when the Washington legislature and governor, at the behest of their union bosses, repealed the opt-in provision, they also declared that henceforth no nonmember agency-fee money would be considered to have been spent on politics if the union receiving the fees had sufficient other money to have made the political expenditures. The fact that money is fungible makes this a nonsense proposition. The agency fees will simply take the place of the non-fee money that would otherwise be spent on something else. The bottom line is the same: Agency fees make increased political spending possible.

Classical liberals should be interested in fighting coercive unionism. The fundamental instrument of coercion is exclusive representation. Without that, the whole union-security question and its concomitant RTW issue would be moot. Without exclusive representation there would be nothing about unions from which a paycheck would need protection.

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The fundamental instrument of coercion is exclusive representation.

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