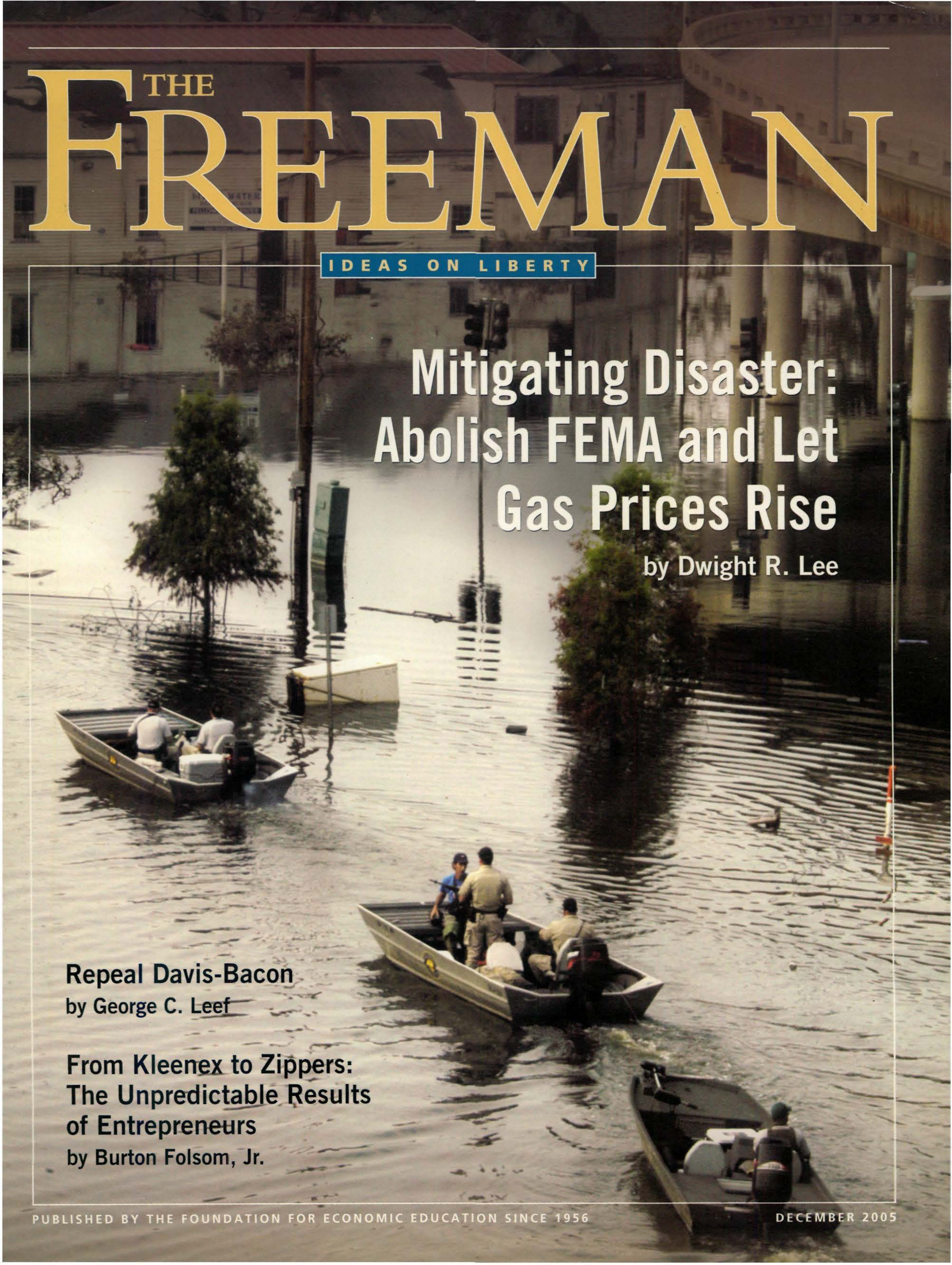

THE FREEMAN

IDEAS ON LIBERTY

Mitigating Disaster: Abolish FEMA and Let Gas Prices Rise

by Dwight R. Lee

Repeal Davis-Bacon

by George C. Leef

From Kleenex to Zippers: The Unpredictable Results of Entrepreneurs

by Burton Folsom, Jr.

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DECEMBER 2005

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December book sale

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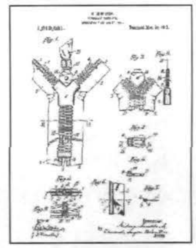
THE FREEMAN
IDEAS ON LIBERTY

VOLUME 55, NO 10 DECEMBER 2005

From the President

Columns



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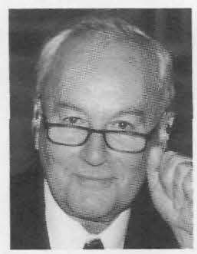

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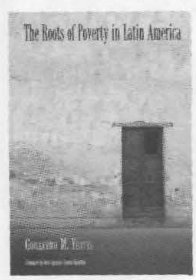

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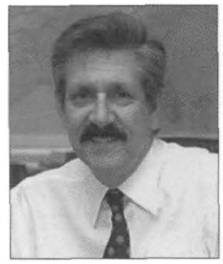

Why Not Monetary Freedom?

BY RICHARD M. EBELING

In all of the commentaries that have appeared since President George W. Bush nominated Dr. Ben S. Bernanke as Alan Greenspan's successor at the Federal Reserve, there has been one crucial question that has remained virtually unasked: Why do we need a central bank and therefore a new chairman for the Fed? In a world that claims to have rejected socialism, central banks remain one of the most powerful socialist institutions around the world—because make no mistake about it, central banking *is* monetary central planning.

The Federal Reserve is a government-created monopoly over the monetary and banking system of the United States, brought into existence by an act of Congress in 1913. Its assigned responsibilities include controlling the supply of money and credit to maintain a "stable" purchasing power of the monetary unit, securing high employment and economic growth consistent with monetary stability, and overseeing the banking system.

Ben S. Bernanke
Courtesy Princeton University

Its primary monetary tool is "open market operations," through which the Fed buys and sells government securities in order to modify the amount of bank reserves available for lending. It thus influences market rates of interest. For example, when the Fed buys government securities, it pays for them by creating money out of thin air; bank reserves are increased, tending to put a short-run downward pressure on interest rates.

Thus the quantity of money, its value, and the market price of borrowing and lending are directly or indirectly under the control or influence of the Federal Reserve. The Fed's seven-member Board of Governors—who are nominated by the President and approved by the Senate—are in essence the monetary central planners of the United States.

Bernanke, who served as a Fed governor before being appointed chairman of President Bush's Council of Economic Advisers, advocates "inflation targeting" as the "framework" that should guide monetary central planning. He rejects a "monetary rule," such as the one proposed by Milton Friedman years ago, under which the Federal Reserve would set monetary policy on "automatic pilot" and simply increase the money supply at some chosen annual rate, say, 3 percent a year. And he equally rejects the old Keynesian belief in complete "discretion," under which the Fed governors would shift monetary policy, possibly day to day, according to whatever seemed to be the economic and political trends.

Instead, Bernanke thinks that the monetary planners should have a longer-term "objective" in mind, such as a rate of price inflation of 2 percent a year around which the actual rate of price inflation may deviate on a month-by-month or quarter-by-quarter basis. The Fed should have the discretion to manipulate the money supply and influence market rates of interest in various ways that may seem necessary or desirable in the short run around that longer-run "target" rate of price inflation.

As Bernanke expressed it in *Inflation Targeting*, which he coauthored in 1999: "We find it fruitful to think of inflation targeting not as a policy rule, but as a framework within which 'constrained discretion' can be exercised. It is here that the nominal anchor function of inflation targets is central: Like a real-life anchor, inflation targets keep the economic ship in the desired area in the long term, while permitting it to respond in the short run to unpredictable swells and currents" of changing market conditions.

In Bernanke's view, inflation and deflation are general price trends that may emerge in the market. The pur-

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pose of monetary policy is to restrain prices in general from moving in one direction or the other.

In fact, a sustained and continuing general rise in prices is impossible without an increase in the quantity of money. Rising prices are the effect of a preceding monetary expansion. But for Bernanke the role of monetary policy is to respond to price trends that seem to arise autonomously. Thus, in reality, the monetary authority is to be the inflation "policeman," "arresting" the rise in prices that its own policy will have created in the first place.

Why does Bernanke advocate an inflation target of, say, 2 percent rather than a target of zero price inflation? Because he believes that if price deflation were to occur, the Fed would need wiggle room to be able to push interest rates even to zero so money can be pumped into the market through the banking system in order to reverse the deflationary price trend. Hence the Fed must target a positive rate of price inflation so as to have the ability to fight price deflation.

A world of unending inflation, therefore, is the optimal "target" to be implemented by the monetary central planners, according to Bernanke. Even an annual rate of 2 percent price inflation, it should be remembered, would reduce the purchasing power of the dollar by half in one generation.

While Bernanke wants the policy discretion of the monetary planners to be constrained within the publicly announced boundary of the inflation target, he and the other Fed governors still implicitly presume to have the wisdom and ability to direct the monetary future of the United States.

The best monetary policy would be no monetary policy at all. The advocate of the free market, therefore, calls for the abolition of the Federal Reserve and the operation of a market-based system of private and competitive free banking.

A Socialist Vestige

Monetary central planning is one of the last vestiges of socialist central planning. The fact is, the Federal Reserve can no more correctly plan for the "optimal" quantity of money or a targeted rate of inflation than any other branch of government can properly plan for the optimal supply and pricing of shoes, cigars, soap, or scissors. And the history of monetary central planning in the United States and around the world has demonstrated the same inevitable failures as all other forms of socialist planning.

The best monetary policy would be no monetary policy at all. The advocate of the free market, therefore, calls for the abolition of the Federal Reserve and the operation of a market-based system of private and competitive free banking.

The following would be the steps to bring this about:

1. The repeal of the Federal Reserve Act of 1913 and all complementary and related legislation giving the federal government authority and control over the monetary and banking system.

2. Repeal of legal-tender laws, which give government the power to specify the medium through which all debts and other financial obligations, public and private, may be settled.

3. Repeal of all restrictions and regulations on free entry into the banking business, including interstate banking.

4. Repeal of all restrictions on the right of private banks to issue their own bank notes and to open accounts denominated in foreign currencies or gold and silver.

5. Repeal of all federal and state rules, laws, and regulations concerning bank-reserve requirements, interest rates, and capital requirements.

6. Abolition of the Federal Deposit Insurance Corporation. Any deposit-insurance arrangements and agreements between banks and their customers, or among associations of banks, would be private, voluntary, and market-based.

In the absence of government regulation and monopoly control, a free monetary and banking system would exist; it would not have to be created, designed, or supported. A market-based system would naturally emerge, take form, and develop out of the prior system of monetary central planning. And monetary freedom would be established.

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Perspective

Bureaucracy Can't Be Run Like a Business

John Tierney is an excellent columnist, by far the best on the *New York Times* op-ed page. He showed it last September when he contrasted Wal-Mart's superlative emergency preparedness with the government's horrible performance during Hurricane Katrina. As he wrote, Wal-Mart is "one of the few institutions to improve its image here after Katrina sent a 15-foot wave across the north shore of Lake Pontchartrain. If you mention the Red Cross or FEMA to people in Slidell [Louisiana], you hear rants about help that didn't arrive and phone lines that are always busy. If you mention state or national politicians, you hear obscenities. But if you visit the Wal-Mart and the Sam's Club stores here, you hear shoppers who have been without power for weeks marveling that there are still generators in stock (and priced at $304.04). You hear about the trucks that rolled in right after the hurricane and the stuff the stores gave away: chain saws and boots for rescue workers, sheets and clothes for shelters, water and ice for the public."

Tierney says that among Louisiana officials, "there's even been talk of letting Wal-Mart take over FEMA's job. The company already has its own emergency operations center, where dozens of people began preparing for the hurricane the week before it hit by moving supplies and trucks into position. . . . I'm afraid the Wal-Mart Emergency Management Agency will be a tough sell on Capitol Hill. But I'd vote for WEMA." At the least, he suggested, Wal-Mart chief Lee Scott should run FEMA.

But Tierney misses an important point. Wal-Mart did so well precisely because it is *not* a government agency or contractor. There is no reason to believe that Scott could run FEMA better than a political appointee or career bureaucrat. This is not meant as an insult. Rather, it's a comment about bureaucracy. There's an old conservative idea that government can be run like a business, but years ago Ludwig von Mises, in his 1944 classic, *Bureaucracy*, showed this to be a misconception.

In that little book Mises contrasts the essential nature of a government bureau with that of a for-profit enterprise. As he points out, these forms of organization could not be less alike. An enterprise can prosper only if it pleases consumers, who are free at any time to take their money and search for satisfaction elsewhere. Thus business owners have an infallible guide to how well they are doing: the profit-and-loss sheet based on market prices for both inputs and outputs.

This combination of consumer sovereignty, free competition, and the price system—which all flow from the same thing: individual liberty—enables enterprises to perform efficiently. That is why market-based societies are far more prosperous than socialist societies and why freer economies do better than more-regulated economies.

A bureaucracy, in contrast, is missing the feedback so essential to capitalist success. It gets its revenue not through the free choices of consumers, but rather from coerced taxpayers who must pay for "services" whether they use them or not, or like them or not. Competition is barred (or hampered), and the "services" are not priced on the market. As a result, a bureaucracy has no need to please consumers and faces no profit-and-loss test. It cannot calculate as a business can. The pro-consumer rule of business, "Make a profit," cannot apply to a bureaucracy, so it instead is required to follow pages of procedural regulations that bear no relation to "customer" satisfaction.

A key implication of the difference between bureaucracies and enterprises is that the former's problems are not merely matters of personnel. Thus what ails a bureaucracy cannot be cured by turning it over to a businessman. Mises writes, "It is vain to advocate a bureaucratic reform through the appointment of businessmen as heads of various departments. The quality of being an entrepreneur is not inherent in the personality of the entrepreneur; it is inherent in the position which he occupies in the framework of market society."

In other words, the businessman won't change the bureaucracy; the bureaucracy will change the businessman. If we want agencies responsible for emergency services to perform as well as Wal-Mart does, they must be where Wal-Mart is: in the marketplace.

* * *

Hurricane Katrina illustrated not only the damage that nature can wreak, but also the damage that government can wreak. Most people would find it counterintuitive that we'd be better off with "price gouging" and without the Federal Emergency Management Agency, but as Dwight Lee shows, in this case the counterintuitive is correct.

One of the few constructive parts of President Bush's unprecedented pledge to rebuild New Orleans and the rest of the wracked Gulf Coast was his short-lived suspension of the Davis-Bacon Act, a legal wage-fixing scheme for federal construction. George Leef explains why the President should have stuck to his guns.

Eighty years ago this month a man was born who would grow up to be a great educator for the freedom philosophy in his country, Guatemala. Donald Boudreaux tells the inspirational story of former FEE trustee Manuel Ayau, who's still going strong.

Stripped of economic jargon, import quotas and tariffs are nothing but forcible interference with individuals' peaceful exchange across national borders. What, asks Manuel Ayau, could be more presumptuous?

After the terrorist attacks of 9/11 the federal government stepped in to bail out the struggling airlines. How did it do? Paul Cleveland and Michael Tucker look at the record.

A Chinese government-owned oil company tried to buy Unocal, but a coalition in Congress made sure the acquisition would not occur. Was that a good thing? See what James Dorn has to say.

With the Labour Party firmly in control and Gordon Brown set to succeed Tony Blair as head of the party, what's in store for Great Britain? Norman Barry reports from the scene.

Here's what our columnists have come up with: Richard Ebeling makes the case for monetary freedom. Lawrence Reed optimistically describes liberal activities in Africa. Thomas Szasz explores the meaning of mad genius. Burton Folsom relates tales from the annals of unpredictable entrepreneurship. Walter Williams continues his Economics for the Citizen series. And Robert Murphy, irked by the claim that Hurricane Katrina proved that government is too small, booms, "It Just Ain't So!"

Books undergoing examination by our reviewers deal with the persistence of poverty in Latin America, energy, economic rights, and global warming.

This being our December issue, we wind up, as usual, with the year's index.

—Sheldon Richman
srichman@fee.org

Hurricane Katrina Shows that Government Is Too Small? It Just Ain't So!

BY ROBERT P. MURPHY

By now everyone is aware of the almost inconceivable incompetence of the Federal Emergency Management Agency's (FEMA) response to Hurricane Katrina. Those who cherish liberty might think this episode would bolster their cause. However, as usual the state's intellectual bodyguards have attempted to use this disaster to justify ever higher budgets and even more dictatorial powers.

An excellent example is economist Paul Krugman, who in his September 5 *New York Times* column blames FEMA's bungling on "the right": "[T]he federal government's lethal ineptitude wasn't just a consequence of Mr. Bush's personal inadequacy; it was a consequence of ideological hostility to the very idea of using government to serve the public good. For 25 years the right has been denigrating the public sector, telling us that government is always the problem, not the solution. Why should we be surprised that when we needed a government solution, it wasn't forthcoming?"

Typical for a government apologist, so let us analyze it carefully: The federal government first arrogates to itself tremendous powers and money to "guarantee" certain outcomes in "essential" sectors, including macroeconomic growth, national defense, education, health care, mail delivery, electricity and other utilities, law enforcement, roads, and the response to natural disasters. Because of government intervention, it is precisely these areas that are the most deficient. The stark failures are then cited as proof of the inadequacy of the free market and to justify another round of political measures.

In fact, the real damage done by the federal government lay in FEMA's rebuff of *private and local-government* help: FEMA officials rejected trucks of supplies from Wal-Mart, prevented the Red Cross from delivering food, turned back a 500-boat citizen flotilla that wished to help with evacuation, turned down offers of generators, refused the Coast Guard's efforts to deliver diesel fuel, and, incredibly, actually sent out an alert to first responders nationwide telling them *not* to respond to the disaster (unfolding on TV) until specifically requested through the appropriate channels. Besides these direct obstacles, President Bush's stern warnings against "price gouging" served to further stymie the flow of goods into the ravaged region.

The government's responsibility for the disaster goes deeper still. As Lew Rockwell has cogently demonstrated ("The State and the Flood," www.lewrockwell.com/rockwell/flood.html), it was not the hurricane per se that ravaged New Orleans, but rather the failure several hours later of the levee system. That system is owned and operated by the congressionally controlled Army Corps of Engineers, hardly starved for money. As the *Washington Post* reported, "[O]ver the five years of President Bush's administration, Louisiana has received far more money for Corps civil works projects than any other state, about $1.9 billion."

Nor was this an unanticipated danger: Ivor van Heerden of Louisiana State University had developed models in which the levees became overwhelmed, and warned of this possibility as Katrina approached. Moreover, *National Geographic* ran an article *last year* that described the vulnerability of New Orleans to a major hurricane. In the private sector, if a particular contractor ignored warnings from experts and thus invited disaster upon his clients, that would spell bankruptcy. Does anyone think the levee system in New Orleans will now be privatized?

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Contrary to Krugman, it was precisely the government's involvement that led to disaster, and it is the continued presence of federal officials that hampers the rescue and recovery effort. Furthermore, it is not simply that the "wrong people" are in charge—as Krugman thinks. Don't misunderstand; I believe former FEMA director Michael Brown deserves all the criticism he has received. His August 29 memo stating that among the duties of federal employees was to "convey a positive image" of the government relief efforts is particularly infuriating. And the absurdities of FEMA's response—such as delaying firefighters two days in Atlanta hotels to receive sexual-harassment training and watch videos on the history of FEMA while people were still dying in New Orleans—are indefensible.

Yet what would Krugman's ideal FEMA chief do instead? Would he or she know how many bottles of water and canned meat were needed in each shelter? Would he or she know whether letting a particular group of eager citizens into a flooded area (with contaminated water, downed power lines, collapsing buildings, and armed looters) would help or hurt the rescue effort? Would Krugman's ideal FEMA chief know how many people to call up for the relief effort, and how to allocate them among various tasks such as restoring utilities, setting up shelters, tending to the sick, and searching for survivors?

Among other ways to view it, New Orleans and other ravaged areas suffered from an *economic* problem. It is not immediately obvious which supplies should be sent to which areas where they will do the most good. (Indeed, part of the problem is to meaningfully *define* the "most good" in this context.) The American public responded generously in the wake of the tragedy, but the besieged FEMA officials didn't know what to do with all of the donations and offers of assistance rolling in. In hindsight, we can certainly conclude that they made bad decisions, but the problem isn't simply that they didn't care, or were put in place through "raw cronyism" (Krugman's description for Brown's appointment).

FEMA Is the Problem

The problem is that a bureaucracy such as FEMA exists in the first place. There doesn't need to be one person or group in charge of coordinating the rescue and recovery after a hurricane, just as there doesn't need to be one person or group in charge of automobile production. In the absence of government-imposed order, private charities and businesses would have catered to the needy in ways they deemed best. Yes, some would miscalculate and direct diesel fuel or volunteer firefighters to the wrong areas, but in a free society (with no FEMA) such mistakes would be limited to those who voluntarily abided by these decisions; other groups and businesses would not make those mistakes, and the overall relief effort would be far more effective.

Even many pro-market writers have failed to push the case this far. The *Wall Street Journal* has run several articles contrasting the shoddy performance of the government with private companies such as Wal-Mart and Home Depot. Inexplicably, after conceding that "a FEMA is never going to operate with the agility of a FedEx" because "FedEx and the others perform at this level 24/7; that's the nature of competition," the *Journal* concluded that "there are lessons here worth learning and attempting to transfer to the public sector." In a similar *Journal* article, Daniel Henninger lamented that the scientific knowledge exists to deal effectively with natural disasters, but that government bureaucracies are "poorly incentivized" and respond to political pressures. Yet Henninger concludes, "A public role is unavoidable and political leadership is necessary."

The vulnerability of New Orleans and the botched relief efforts epitomize the inability of government agencies to prevent or mitigate damage from natural disasters. We do not rely on federal bureaucracies to oversee the transport of resources and the distribution of goods and services in "non-essential" areas during normalcy, and in these areas the free market performs prodigious feats of coordination. It is in the aftermath of a natural disaster—when traditional distribution channels are destroyed and consumer preferences have changed for millions of people—that the dynamism of a free market is needed the most. Yet writers such as Paul Krugman draw the exact opposite conclusion, and interpret a blatant failure of federal emergency "management" as proof of the need for more money and power in the hands of the Leviathan state.

Mitigating Disaster: Abolish FEMA and Let Gas Prices Rise

BY DWIGHT R. LEE

I heard no complaints about the money people were paying for the federal government's relief effort in the aftermath of Hurricane Katrina. I cannot say this about the higher prices for gasoline. It was hard to find anyone not complaining. Why the difference? After all, the extra amount the average family had to pay for gasoline because of the supply disruptions caused by Katrina is much less than the extra taxes it will pay for the Federal Emergency Management Agency's (FEMA) relief effort. When I asked a number of people, including students, why complain about higher prices for gas and not higher taxes for relief efforts, the response was the same—we don't mind paying more taxes to help others, but we don't like being ripped off by greedy oil companies.[1] No doubt this answer reflected sincere feelings of generosity and concern. But it was fundamentally mistaken for at least two reasons.

> The higher gas prices motivated tens of millions of drivers to conserve gasoline, allowing more to be available where it was badly needed.

The first reason is that it fails to recognize how higher gas prices (and higher prices in general) after a natural disaster greatly increase our ability to help others. The second reason is that the political process (as opposed to the market process) reduces our incentives to understand how best to help others, and exploits this lack of understanding to take more of our money to provide far less help than is possible. When these two reasons are considered together, the conclusion is that the most effective things we can do to help disaster victims are: 1) pay higher prices for gas and 2) abolish FEMA.

Of course, most people wanted to help the victims of hurricanes Katrina and Rita, but they wanted to do so effectively. One of the most effective ways of providing that help was by sharing badly needed products, such as gasoline, with those in the devastated area. And higher prices are the most effective way of motivating that sharing.

The higher prices we paid for gasoline reflected the fact that the hurricanes temporarily reduced gasoline supplies. After the hurricanes there was not as much gasoline available as consumers wanted at pre-hurricane prices. Furthermore, more gas was suddenly needed along the Gulf Coast to bring in rescue personnel, evacuate the homeless, help clear the rubble, and get on with reconstruction efforts. The higher gas prices motivated tens of millions of drivers to conserve gasoline, allowing more to be available where it was badly needed. No matter how much sympathy we expressed for the hurricane victims, it is naïve to think we would have reduced our gas consumption much, if any, without a price increase. Most people would have rationalized that their reduction wasn't going to make any noticeable difference, so why should they make a sacrifice when hardly anyone else was?

There were price increases for other products urgently needed in the stricken area, and those higher prices also motivated us to conserve so more would be available to the hurricane victims. We didn't notice the

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higher prices for most of these products as much as we did for gasoline because their supplies were not disrupted to the same degree. But there were a host of price increases that resulted from the shortages along the Gulf after the hurricane, and these prices provided the necessary incentives for all of us to adjust our consumption in ways that helped the victims.

The help we provided by paying higher prices was indirect, and not as easily seen or emotionally satisfying as shipping resources directly to people in need. But we shouldn't let this blind us to the facts.

Of course the victims of Katrina and Rita needed more than extra gas and other products. Many lost not just their homes, but also their jobs and the ability to pay for what they needed. Their very survival often depended on direct shipments of food, bottled water, rescue equipment, medical supplies, and building material. This help is what we are going to pay for with higher taxes that few people complained about because, according to what they say, they don't mind paying what it takes to help people in distress. But there is another reason people don't complain about the amount they pay to finance government relief efforts, and this reason explains why these efforts are less effective than they should be. Almost no one has any idea how much he is paying for relief efforts, and even if he did, he would have little reason to consider whether the relief is being provided cost-effectively.

It is doubtful if anyone really knows how much he pays in taxes. If you prepare your own taxes, you might remember how much you paid in state and federal income taxes last year. But politicians have been masterful at disguising and delaying taxes in ways that make it impossible to really know what our tax bill is and what our money goes for. Who knows how much he paid in sales taxes, or excise taxes, or import taxes (in higher prices), or corporate-profit taxes (also in higher prices), or in inflation, or what the present value is of his future tax increases resulting from current spending, or his share of the productivity losses caused by the excess burden of taxation? Nobody knows.

But even if we did know our total tax bill, we would still have no idea how much of what we pay goes for particular government programs and services, such as relief efforts, or how much more we will pay in taxes because of a natural disaster like Hurricane Katrina. Indeed, few of us are aware of more than a small fraction of the government activities we are paying for. So when the cost of a government activity, like providing relief for hurricane victims, goes up, people simply aren't aware of, or don't register, the increase.

It's not just our ignorance of how much our taxes are and what they are going for that allows politicians to provide us with services that are poorly designed and incompetently delivered and then charge us more than they would be worth even if they were efficiently provided. There is also the problem that individuals can do little about the situation. No one can switch his patronage, and tax dollars, from FEMA to a competitive relief agency.

The Problem with Getting Our Gas from Tax Mart

If gas were paid for and provided as government disaster relief is, an increase in the cost of gas would motivate few if any complaints because the increase would go largely unnoticed. Unfortunately, any motivation for people to adjust their consumption appropriately in response to the higher cost of gasoline would disappear right along with the complaints about cost. Misallocation and waste in the use of gasoline would be guaranteed.

The problems would extend beyond those caused by the lack of consumer information on the cost of gasoline. If gas were provided like disaster relief, we would have to pay through our taxes; gas would then be available at a price of zero at Tax Mart gas stations in quantities determined politically. If you wanted to buy your gasoline from a private supplier, or buy more than your Tax Mart quota allows, you could do so, but your tax bill would remain the same. No one would be surprised if the service and gas were noticeably worse at Tax Mart than at private gas stations. Tax Mart bureaucrats wouldn't have to worry about budget cuts despite lousy service and poor quality gas, since people would continue to put up with its poor performance—the only alternative would be to pay twice for gas. Indeed, Tax Mart's budget might be increased in the futile hope of improving its operation. There would surely be complaints about the quality of the service, but many would confront the cognitive dissonance brought on by their continued patronage of Tax Mart despite its inadequacies by coming up with rationalizations for its problems.

So we shouldn't be surprised that few people complained about the cost of the government's efforts to provide relief for the victims of natural disasters. Neither should we be surprised that the complaints that these relief efforts are generally carried out ineptly, and not infrequently (as was the case with Hurricane Katrina) with almost criminal negligence, do little to motivate improved performance next time. There is little, if anything, any individual taxpayers can do that would noticeably motivate government officials to use tax dollars more efficiently to help victims of natural disasters. With no sense of empowerment, taxpayers have little reason to pay more than passing attention to the inadequacies of disaster relief. Some might become agitated enough to vote against the politicians supposedly in charge, and they might be defeated. But such changes at the top seldom result in fundamental changes in the bureaucratic incentives that ultimately determine the performance of government programs. No matter what group of politicians wins the next election, as long as taxpayers have no idea how much they are paying for disaster relief and have no control over how much they pay whether or not they are satisfied with how well the relief is provided, there is little reason to expect the next relief effort to be any better than the last.

> The waste, delays, and incompetence that characterize FEMA are the result of a free-rider problem inherent in all federal spending programs.

Abolish FEMA

Helping large numbers of people after natural disasters is complicated, made more so by the damage to the physical and social infrastructure needed to provide the help. No relief effort will be flawless. But if those paying the bill for disaster relief knew the price and had some control over how the money was being spent, improvements would be made in the effectiveness and efficiency of the help. Taxpayers can never have the same degree of information and control as they have when buying gasoline. They can be given more information and control than they have now, however, and do more to help disaster victims. How? By abolishing FEMA and getting the federal government out of disaster relief.

The immediate response to the recommendation that federal government quit providing disaster relief is that private responses would be woefully inadequate because of the free-rider problem. Without the federal government forcing everyone to contribute to disaster relief through taxation, people would contribute little if any to private relief organizations (such as the American Red Cross, Salvation Army, United Way, and many other reputable charities), attempting to free-ride off the contributions of others.

The free-rider problem no doubt reduces voluntary contributions below ideal levels after natural disasters. But the question is not whether voluntary contributions are a perfect solution to the disaster relief, but whether the addition of FEMA to voluntary contributions and private relief efforts makes things better or worse. Despite free-rider problems, Americans give generously to private charities to address a host of social problems, and they are particularly generous after disasters, natural or otherwise. U.S. charities raised over $2.2 billion after the 9/11 terrorist attacks, and nearly $1.3 billion for the victims of the 2004 tsunamis. But according to *The Chronicle of Philanthropy*, as of about a week after Katrina hit New Orleans, the pace of private charitable giving to victims was greater than that following these previous disasters.[2] Also, private giving would surely be greater if people were able to keep more of their income and were not lured into believing, as many are, that their tax dollars were taking care of the problems.

It is doubtful, of course, that private charitable contributions would come very close to the amount spent by the federal government. When comparing relief efforts funded by the federal government and those financed by voluntary contributions, however, it is a mistake to concentrate solely on the free-rider problem associated with the latter. The waste, delays, and incompetence that characterize FEMA are the result of a free-rider problem inherent in all federal spending programs. Taxpayers can be forced to pay for FEMA, but they cannot be forced to contribute to those collective actions needed to prevent FEMA from taking too much of their money and spending it in ways that provide too little help for disaster victims and often make things worse. (The current level of government spending for disaster relief undoubtedly increases the harm to life and property. Subsidized insurance and government-financed rebuilding programs lower the private cost of building in areas highly vulnerable to hurricane and flood damage. Making less money available for such subsidies would result in more rational patterns of development, save lives, and reduce property damage in the future.)

Taxpayers and victims of disasters would be better off if each 1) contributed to efforts to monitor FEMA and report on the cost and effectiveness of its activities, and 2) communicated to their political representatives that the resulting information was going to influence how they were going to vote in the next election. But this isn't going to happen because of the government free-rider problem. This problem seldom gets discussed, even though it is probably a bigger obstacle to helping disaster victims today than the free-rider problem associated with private giving would be if FEMA were abolished.

No one denies that contributors to private charities also fail to monitor those charities diligently and that those charities often fail to make the best possible use of the money they spend. But there is an important difference. If the word gets out that the American Red Cross, for example, is not making good use of donations, people can shift their contributions to other private charities that are doing a better job. We don't have this option with FEMA. Instead of getting less money because of its poor performance, FEMA will almost surely get more, with the justification that more is needed to do a better job.

The contrast between the public's response to gas prices after the hurricanes and its response to the cost of government efforts to help the hurricane victims is instructive. The lessons this contrast teaches, if given some thought, are 1) gasoline suppliers were doing a good job serving the public interest because gas prices forced people to accept the harsh realities and motivated them to respond in ways that helped the hurricane victims, and 2) because people had no idea what the government relief effort cost and had no effective way to respond to the cost even if they had known what it was, government did a poor job helping the hurricane victims. Once the fundamental and intractable problems of helping disaster victims by forcing people to fund FEMA are considered seriously, abolishing the agency doesn't seem like such a radical proposal.

1. Once the news started reporting on the delays and inadequacies in FEMA's response, I did hear people complaining about its poor performance. The complaints were not about the costs, but about the people and party in charge of the relief effort and how the right people would have done a far better job.

2. Nicole Lewis and Nicole Wallace, "Americans Have Given at Least $670-Million for Victims of Hurricane Katrina," *The Chronicle of Philanthropy*, September, 9, 2005, http://philanthropy.com/free/update/2005/09/2005090801.htm. The Associated Press later reported that $1.3 billion had been raised privately www.washingtonpost.com/wp-dyn/content/article/2005/09/28/AR2005092801529.html.

Repeal Davis-Bacon

BY GEORGE C. LEEF

After Hurricane Katrina ravaged much of the Gulf Coast, President Bush ordered the suspension of the federal Davis-Bacon Act, which mandates that workers on all federally financed construction projects of more than $2,000 (virtually all, that is) be paid the "prevailing wage" of the project location. The suspension would have covered only the parts of the coast devastated by the hurricane.

Big Labor and its leftist allies howled that this move would be "anti-worker" because it would lift their "wage protection." The howling worked: Bush in late October reinstated Davis-Bacon as of November 8.

The truth, however, is that Davis-Bacon and all the state prevailing-wage laws are price-fixing schemes, enforced by government, designed to shield high-cost unionized workers against competition from more-efficient nonunion contractors. By preventing those more-efficient contractors from underbidding the union rates, prevailing-wage laws ensure that union workers will get most government construction work. A union electrician, for example, is thus able to work at the set union scale, which may actually be more than he often gets in the market, while the nonunion electrician cannot be employed at the rate he is willing to work for. Prevailing-wage laws are special-interest legislation pure and simple, benefiting some workers at the expense of others—and the taxpayers.

Davis-Bacon's congressional sponsors were carrying water for the overwhelmingly white construction unions, which were complaining that contractors were underbidding them by using lower-paid nonunion black workers.

Davis-Bacon is an ugly relic of the legislative hysteria that gripped Washington during the Great Depression. It was passed in 1931 and signed into law by the emphatically non-laissez faire President Herbert Hoover. Hoover was convinced that prosperity could be restored if wages were kept high. With its guarantee that construction wages on federal projects would be taken out of competition, Davis-Bacon seemed to be a good idea to the president.

Its congressional sponsors, however, were not thinking about its supposed macroeconomic effects. They were carrying water for the overwhelmingly white construction unions, which were complaining that contractors were underbidding them by using lower-paid nonunion black workers. Construction unions are labor cartels, seeking to keep wages artificially high by suppressing competition, and just like other cartels, they succeed only if they can have government stifle the competition that naturally occurs in the free market.

Imagine a parallel situation, where the auto dealers in some state want to enjoy higher profits. They get together and agree that no one will sell a car for less than its sticker price. Sadly, they soon discover that their prices are being undercut by nasty outsiders who will negotiate better deals with customers. Their solution? They lobby the legislature for a "prevailing

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price" law that makes it *illegal* for anyone to sell below the "official" price. The law sets up a new government office to determine what the official price of each car is and to enforce compliance.

If we had "prevailing price" laws to "protect" auto dealers, almost everyone would see that it was just a price-fixing conspiracy. I say "almost" because the dealers would attempt to make it seem as though their conspiracy was actually in the public interest. They might claim that by promoting "price stability" they were actually protecting the public against unsafe cars, since a study (of course, they'll be able to conjure up some piece of "research") shows that cars purchased from "cutthroat" dealers have a bad accident record.

The construction unions have done exactly the same thing. They use the government to suppress competition, and their public argument for doing so is that union workers are safer on the job. The safety argument is entirely bogus, but it gives the unions and their political allies a place to retreat to when their competition-stifling law is questioned.

Prevailing-wage laws largely, although not entirely, shut nonunion construction firms out because their work is not organized around the rigid and inefficient job classifications the unions use. Trying to fit a nonunion firm's round peg into the square hole of prevailing-wage regulation is usually too troublesome, so government construction overwhelmingly goes to unionized contractors. That's exactly what the unions want. Economist Morgan Reynolds made the point clearly in his book *Making America Poorer: The Cost of Labor Law*. He wrote, "Eventually, construction unions will be confined to federally financed construction, where union inefficiencies are protected by the Davis-Bacon Act. In open competition, the building-trades unions—with their exorbitant wages, inefficient work practices, and strikes—cannot survive."

Taxpayers are hit twice with needless costs due to Davis-Bacon. First, the costs of federal building projects are inflated. It's impossible to say exactly how much so because we can't know how much lower the bids would have been if the cost of labor weren't fixed by government edict. In 2003 the House Budget Committee, in recommending repeal or at least curtailment of Davis-Bacon, concluded that application of the law typically increases costs by 5 to 15 percent, and sometimes as much as 40 percent. A lot of tax dollars are wasted due to the prevailing-wage law. And of course, some of those dollars end up being paid back to union treasuries in dues, to be used in lobbying for more federal construction.

Rigging the Game

The second hit on the taxpayers is for the Department of Labor (DOL) bureaucracy that's necessary to determine the "prevailing wage" rates. That function isn't even done honestly much of the time; DOL bureaucrats have been known, for example, to say that the rate "prevailing" in a rural area is actually the union scale in the nearest large city. But even if every prevailing-wage determination were done "accurately," it would still be a complete waste of time since we can (and should) rely on competition instead. There is no need for government officials to determine the cost of any part of a construction bid.

Suspending Davis-Bacon for the construction work done in the aftermath of Hurricane Katrina would have been perfectly sensible. It would be more sensible yet if Congress would just repeal this anticompetitive relic. As long as we have to put up with government construction, at least we ought to get the benefit of full competitive bidding.

There is, however, a solution that's better still. Back in the Red Scare of the 1950s, when people were frantic over the prospect of communists in government jobs, former *Freeman* editor Frank Chodorov said, "If you're really worried about communists in government jobs, why not just get rid of the government jobs?" Similarly, if you're worried about excessive federal spending on government construction projects—and you should be—why not stop, or at least greatly curtail, government construction projects?

Africans Whom Westerners Should Heed

BY LAWRENCE W. REED

At the G8 Summit in Scotland last July, hosted by Britain's Tony Blair, European and North American politicians (all of them white) cried crocodile tears for the plight of black Africans. Echoing a gaggle of actors, rock stars, socialist ideologues, Third World dictators, and other learned economic-development experts, they called for another transfer of wealth from developed nations to the undeveloped ones of Africa—which, by most measures, would seem to exclude no country on the continent.

G8 leaders want governments to dramatically boost the overall level of foreign aid to Africa and grant relief for debts incurred by African regimes. The magnitude of the proposed subsidies brings new meaning to the usually pejorative phrase "throwing money at the problem."

Bold, imaginative leadership? New, creative solutions to intractable problems? Hardly. More like political posturing, expensive guilt trips, and ignorance of reality and economics. The collective response of thinking people should be, "Been there, done that."

Indeed, that *is* the response of a growing number of thinking people in Africa itself. Not the governments there, of course, whose fingers foreign aid must often slip through first before trickling into the mouths of the hungry citizens they oppress. Not the rich, transient showmen like Bono who think they've "experienced Africa" by venturing out of a five-star hotel with a digital camera. I'm referring to Africans who have seen firsthand what foreign aid has done to their countries, who understand what really makes an undeveloped country become developed, and who are writing and speaking out with a boldness and erudition that is challenging the failed status quo.

One such man is former grade-school teacher James Shikwati of Kenya (the subject of this column in May 2002). Thirty-four-year-old Shikwati made waves in both Europe and Africa in a July interview published by Germany's *Der Spiegel*. "For God's Sake, Please Stop the Aid!" screamed the headline. Shikwati argued that billions in past aid have simply fattened bureaucracies, bred corruption, and fostered complacency at best. At worst, aid has weakened local farmers and entrepreneurs, who can't compete with free foreign stuff. "If the industrial nations really want to help the Africans," he declared, "they should finally terminate this awful aid."

Shikwati's think tank, the Inter-Region Economic Network (www.irenkenya.org), fosters free-market economic education. It hosts seminars in east Africa focused on training Africans to develop their own entrepreneurial talents and oppose government policies that stand in their way. He believes that development cannot happen as long as large numbers of Africans, encouraged by Western statists, think of themselves as victims and beggars. Instead of acting like "a child that cries for its babysitter," he says Africa "should stand on its own two feet."

Leon Louw of South Africa was all but alone when he said similar things in the 1970s. This year, the 30th anniversary of his Free Market Foundation in Johannesburg and Cape Town (www.freemarketfoundation.com), he can celebrate the fact that groups like his and Shikwati's are on the rise in Africa—and striking a chord with ordinary Africans as they put the policies of governments at home and abroad under the microscope.

In Africa's most populous nation, Nigeria, criticism of Western aid is echoed by former journalist Thompson Ayodele (also the subject of this column, in April 2003). As founder and head of the Institute of Public Policy Analysis (www.ippanigeria.org), Ayodele observes that "From 1970 to 2000 Africa received about $400 billion in aid. Africa has got enough financial help from overseas. . . . If anyone really wants to help poor Africans out of the vicious circle of poverty he must promote free

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commerce, protect property rights, encourage openness to trade, allow markets to flourish and reduce government intervention in the economy."

Ayodele doesn't want Tony Blair's money, but he does want a policy change. "Prime Minister Blair should use the same zeal and commitment which he now devotes to promoting foreign aid and debt cancellation to call instead for the phasing-out of trade-distorting subsidies and tariffs among his allies which total $1 billion a day. Abrogating those policies would do far more to improve the lives of millions of poverty-stricken people in Africa than any amount of foreign aid."

Harmful as they are, trade barriers imposed by non-African countries aren't nearly as bad as the barriers African governments foist on fellow Africans. Average tariffs within Africa, the IMF notes, are more than 50 percent higher than in the rest of the world. Figures from the World Bank indicate that while sub-Sahara African nations hit agricultural commodities from Europe with an average tariff of 19 percent, they burden similar products from their neighbors with a staggering 33.6 percent rate. Moreover, goods sit stranded by red tape at customs in sub-Saharan countries an average of three times longer than they do in western Europe.

For decades Kenyans could buy Ugandan foodstuffs from Britain for less than they could buy them from nearby Uganda. Free traders like Shikwati have imagined how much better off Kenyans would be if they could avoid their own tariffs and the British middleman by buying directly from Uganda. Finally, last January free trade scored a victory when several east African countries signed a joint customs-union protocol that reduced or eliminated many tariffs.

New Liberal Think Tank

Liberalizing trade within Africa is a recurring theme of one of the continent's newest think tanks, Imani: the Centre for Humane Education (www.imanighana.org). Its founder, Franklin Cudjoe, believes that "a huge deficit of market-oriented policies is the main factor holding Africa back." He notes that trade restrictions underwrite the massive inefficiencies of state-protected industries at the expense of consumers. His organization is educating young scholars in his native Ghana to promote the needed changes.

Cudjoe speaks in brutally honest terms about the high-level corruption that steals savings from citizens and capital from entrepreneurs. Government spending throughout Africa, he says, routinely funnels both aid and tax dollars to the politically well-connected. When foreign-aid advocates claim that a child dies in Africa every three seconds from hunger or disease, Cudjoe poignantly asks, "But do you realize that $4,700 gets stolen by African governments every second?"

When the Dutch-based airline KLM offered to begin flights from Ghana to neighboring countries, Ghanaian government officials demanded bribes. KLM pulled out. "Western nations didn't do that to us, and Western aid only helps keep such a system going," Cudjoe says.

It's even harder to see how Westerners can be blamed for troubles in Zimbabwe when its leader, Robert Mugabe, lives like a prince as his Marxist policies squander the nation's dwindling wealth. This past summer alone, Mugabe's goons forcibly displaced three-quarters of a million people in a campaign against private enterprise and his political opponents. Hundreds of thousands are shivering in tents and hovels, their homes and businesses razed. Does anyone besides Jesse Jackson and Al Sharpton think that what Zimbabwe really needs is a boatload of Western cash?

Market advocates throughout Africa have come to a conclusion once famously expressed by the comic strip character Pogo: "We have met the enemy and he is us." They understand that foreign subsidies may salve the consciences of naïve foreigners, but they perpetuate the poverty-creating cultural and political pathologies that Africans must shed. They have stepped forward and devoted their careers to filling a longstanding void in discussions about Africa.

If there is reason for hope in Africa, it is not because Westerners may foolishly throw more good money after bad. It is because Africans like Shikwati, Louw, Ayodele, and Cudjoe are plainly telling the world about the painful lessons we all must learn from past policies.

Manuel Ayau: Guatemala's Liberal Searcher

BY DONALD J. BOUDREAUX

Driving to my hotel from the Guatemala City airport on my first trip to Guatemala in January 2000, I commented to my host that I was pleasantly surprised to find no customs agents ransacking people's luggage. In fact, once my fellow fliers and I had our passports stamped by the passport-control officials, the airport was refreshingly clear of the usual swarms of harassing government officials.

My host smiled and said, "I pushed for that. For *years* I pushed for that. Finally I won." He spoke these words not boastfully, just matter-of-factly.

Normally I would have been skeptical of such a claim. But in this case I immediately knew it to be true. My host, you see, was Manuel F. Ayau, whom I'd known for several years. He was a valued member of the board of trustees of FEE during my presidency of that indispensable organization. I knew that Muso—as he is affectionately called—possesses an almost superhuman ability to get things done, to make good things happen, to move matters forward.

He continued to explain his motives for ridding the airport of routine customs checks. "When I first brought Mises to Guatemala back in the '60s, I of course met his flight when it landed. I was standing next to him as a customs agent searched the contents of his luggage. Mises leaned over to me and remarked, 'They're making sure that I'm bringing no wealth into your country.' I determined then and there that I would work to put an end to that nonsense."

It took over three decades, but Muso eventually succeeded. No officials today patrol against wealth brought to Guatemala by passengers flying into its capital city.

What a remarkable achievement.

Remarkable achievements are often the result of remarkable individuals. Muso is remarkable.

Muso was born in Guatemala in 1925 and celebrates his 80th birthday this month. Although his parents were Guatemalan, they had spent much time in the United States. His father attended Cornell University and even fought with the U.S. Expeditionary Forces in World War I. Unfortunately, his father died when Muso was only five.

Perhaps the added family responsibilities that soon fell on Muso as a young boy help explain his nickname. Rumor has it that little Manuel was always eager while at play to take commanding lead of his siblings and cousins, so much so that—helped by a Mussolini costume (!) that a relative bought for him—a family member one day remarked that Manuel was indeed much like the Italian strongman.

While it's true that Muso is a leader, it's more than ironic that he is nicknamed after a dictator. No man is more averse to autocratic rule, and no man has labored with more diligence and single-mindedness on behalf of free markets and the rule of law than Manuel Ayau. Regardless, though, the nickname stuck.

Following the wishes of his late father, Ayau studied in the United States. He attended high school in California and earned his degree in mechanical engineering from Louisiana State University. During this time, in the midst of World War II, he also volunteered for a stint in the Royal Canadian Air Force. Muso then returned to his native Guatemala to manage a family firm that produced industrial gases.

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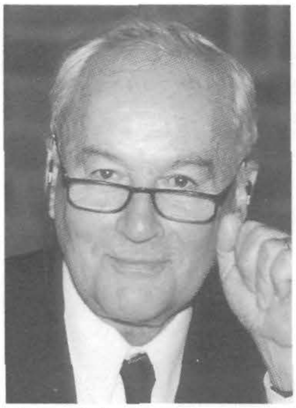
Soon encountering burdensome regulations, corrupt bureaucrats, and absurd taxes, he joined with other Guatemalan businessmen seeking to free consumers and producers from the then-dominant command-and-control regulatory regime that was suffocating commerce. But as Muso once recalled to me, "I quickly became disillusioned. Even when we won a battle now and then, we continued to lose the war against statism. I realized that we would make no real progress unless we changed the underlying *ideas* of the people. We had to take a long-run perspective. I learned that freedom must triumph in people's minds and hearts before it can make any headway in politics."

So in 1958 he and six like-minded friends founded the Center for Economic-Social Studies, better known by the Spanish acronym "CEES." As Muso writes in an unpublished memoir, "CEES's goal was to study and disseminate the ethical, economic and legal principles of the free society."



Manuel F. Ayau
Courtesy of UFM

CEES embarked on an ambitious program of translating into Spanish classic works of economics, political philosophy, and law that were not then available in Spanish—works such as Mises's *Theory and History* and Frédéric Bastiat's *The Law*. And not only translating and distributing them, but also reading and studying them. In addition to running his business and helping to administer CEES, this effective doer is also a deep thinker. He and his CEES associates studied and discussed the works of Mill, Mises, and Hayek, among others. In this way they became impressively self-taught in the social sciences.

As CEES's reputation grew, other Latin American liberals took notice. In 1959 the people at Mexico's Institute of Economic and Social Research introduced Muso and his CEES colleagues to FEE. FEE and its founding president, Leonard Read, in turn introduced Muso and his fellow Guatemalans to Mises, Henry Hazlitt, Ben Rogge, Dean Russell, Israel Kirzner, Hans Sennholz, and other prominent liberals active in the United States.

Over the years CEES sponsored talks and seminars in Guatemala by these and other liberals. In addition, CEES produced a weekly radio program, wrote and distributed thousands of op-eds, and even created a few television programs explaining liberalism. Note that these efforts were not those of businessmen seeking merely to lobby the government for favorable policy changes *today*. Even those who disagree with CEES's goals cannot help but be impressed with its long-run, principled focus.

Still, for Muso and some of his closest friends, especially Ulysses Dent, CEES was not enough. They believed that the best hope for liberalism's long-term health in Guatemala was a high-quality, private university immune to ideological fads du jour—a university committed to scholarship, to open and rational discourse, and to basic principles of human dignity and freedom.

The Achievement of a Lifetime

Opening a university is no easy chore. The problem isn't so much the cost. While brick-and-mortar buildings, competent administrators, and committed and capable faculty are all expensive, Muso and his friends were accustomed to securing and investing large sums of money. But in the past their investments were in profit-seeking enterprises designed to start returning financial gains within, at most, four or five years.

A university is different. Its goal was not to earn financial profit but to change the climate of ideas over the course of generations. Although students would be charged tuition, the university's expected cash flow would never cover all expenses. Personal resources and fundraising efforts were necessary at the start and would remain necessary for as long as the university operated.

Just as important as money, though, was confidence in the power and value of liberal ideas—and patience. When the university was still only a dream, one of Muso's friends initially balked at a request to contribute to the campaign for its founding. This friend remarked that a university is too long-run a project; resources invested today won't bear fruit until two or three decades have passed. Agreeing that his project was indeed long-run, Muso asked his friend to describe a quicker way to fundamentally change ideas. Unable to think of any quicker way, this friend became a contributor.

But the greatest obstacle for any upstart university is developing the reputation necessary to attract the kinds of students capable of becoming tomorrow's leaders. With four other universities in Guatemala—most of which charged little or no tuition because they were funded generously by the government or the Catholic church—any new university would be at a real disadvantage.

One person's disadvantage, however, is another person's challenge. Muso was aware of the difficulties in starting a university from scratch, but he also realized that a key to its success lay in the very reason he sought to start it—namely, all the existing universities were dens of dogmatic statism, including the then-fashionable liberation theology, in which critical thinking had been supplanted by uncritical emoting.

So Muso came to see that his lack of experience in academia was no handicap. His inexperience in this area, in fact, was likely a plus. Because so many lifelong academics, then as now, seemed irresistibly drawn toward top-down coercive "solutions" to all problems, Muso's *non*academic background might well insulate him and his fledgling university from the statist tendencies that are so prominent in the academy.

Still, by any objective reckoning, the odds were against the success of a new, private university in Guatemala. The odds were wrong.

In January 1972 the Universidad Francisco Marroquín (UFM) opened its halls to students. Muso was its president, a busy position that he held until 1989.

In the three and a half decades since UFM taught its first students, it has established itself as the premier university in Central America—all the while keeping to its original liberal moorings and goals. Offering programs in business, the hard sciences, engineering, liberal arts, architecture, medicine, dentistry, and law, UFM attracts the finest students from throughout Central America. And regardless of any student's chosen concentration, he or she studies the works of Mises, Hayek, and other great expositors of liberalism and market theory.

I've lectured many times at UFM and can personally attest to the impressive high quality of all that it is and all that it does. It's immensely gratifying to walk the pathways of a beautiful campus and see students carrying their dog-eared copies of *The Constitution of Liberty*, *Human Action*, or *The Wealth of Nations* as they head for study sessions at the Ludwig von Mises Library. Whenever I'm at UFM—a physical and intellectual oasis in the heart of Guatemala City—I cannot help but be amazed at Muso's achievement.

Planners Versus Searchers

In his forthcoming book, economist William Easterly contrasts "planners" with "searchers." Each planner has Big Plans—a detailed blueprint for achieving in one fell swoop fundamental, large-scale, magnificent change through top-down direction. In contrast, each searcher wisely realizes that Big Plans are hopeless (and fraught with danger). A searcher might desire fundamental, large-scale change as sincerely as any planner does, but the searcher is practical; he judges courses of action not by how fine they sound to romantic ears but rather by their *practicability*.

Muso is a searcher. He aims for what is within his reach. Muso's ultimate goal of making Guatemalans free and prosperous is a grand aspiration, so grand that it cannot be achieved with a Big Plan. Being a searcher, Muso realizes that the best that he (or anyone) can do is to approach this goal step by step—by talking to friends and acquaintances, by translating books, by writing op-eds, by founding a university. Also, Muso possesses two other qualities of the searcher.

First, the searcher understands how to formulate achievable goals so that, once achieved, each one serves as a stepping stone toward the ultimate goal. We might call this "the searcher's vision." Anyone can easily envision his own version of the good society. But many people let their vision of the ultimate goal turn them into planners longing for a Powerful Authority to implement and enforce the vision.

Such people—Karl Marx is a prime example—are typically honored by being called "visionaries." But because Big Plans are inevitably dysfunctional, the societies that such "visionaries" envisage as resulting from their Big Plans are just that: images, mirages, fantasies, delusions. The actual awful results of Big Plans are never foreseen. Therefore, planners are never truly visionaries. Instead, they are what we might call "delusionaries"—people whose delusions blind them to reality.

True visionaries are always searchers, understanding that the ultimate goal and all but the next step or two toward that goal are too distant for anyone here and now to see or predict *in detail.* So the "searcher's vision," while keeping the ultimate goal always within the searcher's sight, focuses his gaze on achievable next steps likely to get him closer to that goal. The searcher, following this vision, takes these steps.

Second, the searcher is patient. He resists urges to leap toward the ultimate goal, for he knows that any such leap would be blind and futile. He's confident that once today's best achievable step is taken, his "searcher's vision" tomorrow will show him the best follow-up step. Compared to taking great leaps through Big Plans toward the ultimate goal, the searcher's process is often tedious and seldom exhilarating. Its great advantage is that it offers the only likelihood of success.

Although they appear to be mundane, searchers' qualities are remarkable and too rare. It is only through the patient, wisdom-guided efforts of searchers that humankind achieves goals that are noble and lasting.

In his long and productive life, Muso the Searcher can take pride in genuine achievement—achievement not confined to Guatemala. In addition to his many pressing duties there, he also served as president of the Mont Pelerin Society (1978–80) and trustee of Liberty Fund. But, of course, it is his native country that owes him the greatest debt.

Because of Muso, the community of liberal scholars, journalists, and business professionals in Guatemala today is among the most impressive in the world. Its vitality is contagious. Will it ultimately result in a Guatemala governed by the rule of law and suffused with private property rights, free markets, and prosperity? Only time will tell, but the chances that this dream will one day become a reality are unquestionably much higher because of Manuel Ayau—one of liberalism's truly great searchers.

Presumptuous Protectionism

BY MANUEL F. AYAU

If someone gets caught selling somebody else's property, he goes to jail. What may be legally bought and sold in the market is limited to legitimate private property acquired by one's own effort or through voluntary exchange with others. Since legal transactions are settled accounts, what is traded belongs to neither the government nor the community. It is private property, and as such the owner can dispose of it at his sole discretion, limited only by other people's rights. Correct?

Incredibly, people discuss international trade as if what is traded belongs to society and this legitimizes government interference with and even imposition of taxes on people who trade but happen to live in different countries. Even more incredible, the amount of tax depends on the thing that is traded: if you import gloves, you are taxed differently than if you import a TV set even though in both cases what was traded were property rights. The intellectual misconceptions, confusions, and inconsistencies related to international trade are exposed in the pompous statements of "authorities." Here are a few things those authorities don't understand.

> Incredibly, people discuss international trade as if what is traded belongs to society.

Countries don't trade. Only people can exchange what belongs to them. It is you, the consumer, who does the importing, and not the dealer who acts as your agent. It is you who ends up paying the tax if you buy an imported car, for the price has to include the reimbursement to the dealer for the import tax he paid to the government on your account. And, obviously, the tax is not on the car, for it cannot pay any tax at all. It is on you.

Trade is triangular. The butcher does not have to get a haircut to trade with the barber. Nor do the Japanese have to drink more coffee to sell more cars to Guatemala. There is no such thing as a trade balance between traders in a civilized society other than that, ultimately, payments between countries must balance; otherwise, somebody is getting something for nothing—not very likely. And payments are not solely for goods and services, for money is also traded for investment or lending.

When stripped to essentials, trading property rights is simple: When a tailor in the United States wishes to have a TV, he doesn't attempt to exchange his garments directly with the Japanese who owns the TV set; he makes a garment (his private property) and perhaps exchanges it with a person who lives in Germany who, in turn, gives him euros (his private property). Then the tailor exchanges those euros for yen, which will soon become the private property of the Japanese who transfers to the tailor the property title to the TV set the Japanese legitimately owns. What is traded in the chain of exchanges are property rights to things, and as far as I know, no one has claimed that the legitimacy of property rights depends on one's political jurisdiction. It is increasingly accepted that property rights to things depend only on their being acquired legitimately. Other than using or consuming a thing, the only way of exercising property rights with respect to it is through trade.

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Second, the upshot of all export activities is to sell the foreign exchange, or currency, locally to potential importers in order to recoup the costs and cover his expenses in local currency. Since foreign exchange is used mainly to pay for imports, the exporter's market is really in his own country. The lower the import taxes are, the greater the demand for imported goods and, consequently, the higher the price for foreign exchange. Taxing importers thus reduces the income of exporters who, as a result of the import tax, receive a lower price for their foreign exchange. Thus, unwittingly, most of the import taxes end up being paid by the exporters. Indeed, if import taxes were high enough to practically eliminate imports, exporters would have to find another occupation or go broke, for to whom would they sell their final product, foreign exchange?

Third, one produces exports to be able to import. Exports are the means, imports the end. The civilized world depends on the division of labor and subsequent trading, no matter the political jurisdiction of those involved. Nobody spends more resources making something that he could import while spending fewer resources, and it is this difference in resources spent—the buyer's profit—that drives exchange. When trade is inhibited by barriers, we are forced to forgo satisfactions because we must make things ourselves that we could have imported at lower opportunity cost. People trade goods in order to incur the lowest opportunity cost. It is relative opportunity costs, not absolute costs, that drive trade between localities, be they in the same or in different countries. This is called by economists "comparative costs."

One produces exports to be able to import. Exports are the means, imports the end.

Fourth, so-called free trade treaties are in vogue, but they constitute bureaucratically managed trade and require trade barriers. Otherwise why have a treaty? If one were to visualize free trade, one would be wise to examine the best example of a free-trade area, comprising 23 percent of the economic world and where the inhabitants have enjoyed free trade without a treaty for over 200 years: the United States of America.

Apparently, the people involved in determining commercial policies in the world today are not conscious that they are dealing with private property rights. And it is obvious that they confuse absolute costs with comparative costs. Since they are "very important people," it is unlikely that they will pause and reflect when these things are pointed out to them. After all, the theory of comparative costs was considered by Professor Paul Samuelson to be the most counterintuitive proposition in all the social sciences.

The best option for a country is to unilaterally remove the barriers it has inflicted on its own citizens. It is they who are deprived of the benefits of competition, who cannot have fluid access to international supplies, who suffer the consequences of corruptive incentives and the social decomposition, privileges, cronyism, regressive wealth transfers, and so on that go with mercantilist import restrictions. Uneconomical diversion of trade reduces productivity and thus makes countries less competitive. New vested interests emerge in response to regulations, and so it seems likely that managed trade is here to stay awhile, preventing the removal of trade controls and regulations. Would that people respected property rights.

The Mad-Genius Controversy

BY THOMAS SZASZ

Our ideas about genius, madness, and the existence of a close relationship between them are modern inventions. For millennia people explained the world about them—especially creative/good and destructive/bad behaviors—in spiritual or god terms.

In the biblical view, creativity is the prerogative of a single supreme Creator. The Scripture attributes the miracle of life to a specific divine act: "And the Lord God formed man of the dust of the ground, and breathed into his nostrils the breath of life; and man became living soul" (Genesis, 2:7). Hence comes our notion of *inspiration* as an explanation for great works of art and science. The idea of in-spiration—of breath, soul, or some other mysterious "substance" entering the person from without and enabling him to perform exceptionally good or bad deeds—has never lost its influence on Western thought. It is the source of the notion of possession (by spirits), and its modern successors, "possession" by the *creative inspiration* of genius and by the *destructive irresistible impulse* of madness. We replace spirit-god words with body-mind words and exult in our smug conviction that we are explaining exceptionally good and bad behaviors scientifically.

The term "genius" comes from the Latin *gignere*, meaning to beget. In the Roman world every person was attended by a tutelary deity or spirit, his *genius*. The Latin *inspirare*, from *in* + *spirare*, to breathe, meant to influence, move, or guide by divine or supernatural inspiration. None of these notions had anything to do with illness or mental illness in the modern sense.

The pseudoscience of psychiatry has, in effect, replaced *spirits possessing the person* as an explanation for his *devilish mind* with *chemical processes in the brain* as an explanation for his *diseased mind*. The ancients believed in spirits: they were not empiricists and needed no evidence of the material existence of spirits. We moderns are "scientific" and demand empirical "proof" for medical explanations. In the absence of objective evidence for the claim that brain chemicals cause creativity-genius and crime-madness, psychiatrists and science writers use the testimonials of celebrities to support their claim.

Alongside the romantic image of manic-depression as a cause of creativity that does not detract from the subject's intentionality for his conduct and responsibility for his good deeds stands the bleak image of schizophrenia as a cause of criminality annulling the subject's intentionality for his conduct and responsibility for his bad deeds. This interpretation, too, lacks objective proof. Instead, its "truth" is enshrined in, and is taught by, the modern clerical and clinical practices of the insanity excuse/defense. Clergymen of all denominations bury *all* persons who break the religious law against self-killing in consecrated ground, "diagnosing" all suicides automatically *non compos mentis* at the precise moment of their sinful deed. Similarly, the insanity defense allows lawyers, judges, psychiatrists, and society to incarcerate *some* persons who break secular laws in prisons called "hospitals," "diagnosing" all such criminals as having been *non compos mentis* at the precise moment of their illegal action.

The belief that research in neuroscience and psychiatry will "explain" the alleged connection between genius and madness is a typically modern delusion. Almost a hundred years ago the great German psychiatrist Ernst Kretschmer (1888–1964) acknowledged that the notion of "mad genius" is a psychiatric invention: "Since the Italian alienist, [Cesare] Lombroso, first coined that pregnant expression 'genius and madness' there has arisen in educated circles a very lively discussion, which, however, has been forced to close with the

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recognition that modern psychiatry has been responsible for—some might say guilty of—establishing such a connection."

Genius and madness are vague terms. The only thing clear about them is that, by definition, each term refers to a type of psychological abnormality, *a deviation from a behavioral-social norm.* Genius and madness are value terms, not medical or scientific terms.

In its contemporary use, then, the term "genius" simply means being very good at something. Being exceptionally virtuous and being exceptionally wicked both count as genius. Stalin and Hitler were geniuses: they excelled in mass-producing corpses, just as Henry Ford excelled in mass-producing cars.

The modern meaning of genius as hereditary excellence was shaped largely by Sir Francis Galton (1822–1911), the father of eugenics. Galton was born into a wealthy and distinguished Quaker family. Charles Darwin was his cousin. "Darwin had thought mainly about the evolution of physical features, like wings and eyes," science writer Jim Holt observes. Applying the same hereditary logic to mental attributes, like talent and virtue, Galton lamented: "If a twentieth part of the cost and pains were spent in measures for the improvement of the human race that is spent on the improvements of the breed of horses and cattle, what a galaxy of genius might we not create!"

How did Galton know that genius is hereditary? The same way that the modern psychiatrist, imitating Galton, knows that manic-depression is hereditary. In his 1869 book *Hereditary Genius*, Galton assembled long lists of eminent men—judges, poets, scientists, even oarsmen and wrestlers—to show that excellence ran in families.

A cow produces prodigious quantities of milk: she is a bovine genius. A man paints beautiful pictures: he is an artistic genius. Einstein is a scientific genius. Mozart is a musical genius. Are Abraham, Moses, Jesus, and Mohammed religious geniuses? Are we explaining achievement when we attribute it to the fictitious entity we call "genius," or are we deceiving ourselves the same way that the scientifically unsophisticated person deceives himself when he declares that hydrogen burns because it is "flammable"?

It is true that breeders of animals can produce cows that give lots of milk and horses that win races. The breeder decides; the animal (re)produces. People already do something like this. Men and women choose mates with whom to have children, and bring up children to cultivate the skills (traits) that they, the parents, value. The child can no more choose his parents than the horse can choose its owner-breeder. But the child soon gains power—both physical and legal-political—to cultivate the traits he values, and reject the traits he disvalues. Doing so, he often displeases his breeders, his parents.

A Mad Genius?

What kinds of persons would a breeder of humans want to produce? Obviously, the answer depends on the values and goals of the individual who controls the breeding. Galton wanted to breed a race of persons resembling himself, "creative geniuses." Ironically, the Galtons had no children. He or his wife was sterile. Galton was said to have suffered two "nervous breakdowns." Was he a mad genius?

The two great twentieth-century dictators both fancied themselves geneticists. Stalin personally elevated Trofim Lysenko to the status of genius and made him, in 1928, the genetics czar of the Soviet Union. Lysenkoism became a campaign against genetics and geneticists: scientific genetics was stigmatized as a "fascist science," and the leading geneticists were executed or exiled. The term survives as a metaphor for false beliefs, refuted by empirical evidence but preferred for ideological reasons. Persuaded by the Marxist-Leninist ideology that breeding a "new Socialist man" was a task for politics not biology, Stalin was not interested in using eugenics as a political tool.

Hitler, in contrast, went all the way politicizing Galtonian eugenics. He too sought to improve the "human stock." The genius he admired was martial and misogynist: men should be warriors; women should be mothers; and all should be members of the "Aryan race." Accordingly, Hitler sought to breed "healthy" Aryans and eliminate "racial degenerates," such as Jews, Gypsies, homosexuals, and the mentally ill.

Science explains physical events. Scientism justifies social policies.

The Futility of the Government Airline Bailout

BY PAUL A. CLEVELAND AND MICHAEL D. TUCKER

In recent years many airlines have struggled, and following 9/11 Congress passed a massive aid package aimed at rescuing the industry. After years of government aid it is appropriate to ask what has been accomplished. Was the bailout truly necessary, or did it simply ignore the economic realities of the airline industry? Has the aid merely propped up weak and inefficient firms at taxpayer expense even though they will eventually fail?

The airline industry faced difficulty long before the events of September 2001. For years the union-burdened old-line hub-and-spoke carriers, such as US Airways, American, and Delta, had struggled against increasing competition from smaller, more efficient, and more cost-sensitive competitors, such as Southwest Airlines.[1] After 9/11 the financial hardships faced by the traditional carriers were exacerbated, and this provided a unique opportunity for these firms to petition the government for help. A little more than two weeks after the attacks, Congress passed the Air Transportation Safety and System Stabilization Act, which provided aid valued at as much as $15 billion.[2]

> Adjustment is part of the market process, but government interference interrupts the process by allowing poor performers to hang on.

Under the terms of the legislation, $5 billion was paid out directly. Roughly 90 percent was given to passenger airlines, with the balance to cargo carriers. The amount paid to each company depended on its market share, which was determined by its proportion of available seat-miles offered in the market. For instance, US Airways, the company with second largest share of available seat-miles, received nearly $800 million.[3] The remaining $10 billion was to be used by the Air Transportation Stabilization Board (ATSB) to guarantee loans. The ATSB was authorized to extend loan guarantees according to rules that made its mission statement so nebulous that it could grant almost any request.[4]

In her study of the package, Susanna Dokupil examined the two main arguments for the cash payments.[5] First, in the wake of the 9/11 attacks, proponents maintained that the government's grounding of all airlines was reason enough to provide some financial aid. To be sure, the forced grounding of all aircraft for several days did impose a financial cost on the carriers, and there is some justification for this argument. Second, those in favor of payments also asserted that the U.S. government had an obligation to compensate airlines for the drop in demand for air travel after 9/11. According to this argument, since the airlines could not have foreseen the attacks and the resulting drop, they should not be held financially responsible.

This second argument makes much less sense than the first. We agree with Dokupil on this point. She asserted that any compensation paid to air carriers because of a drop in demand is illogical because the potential business risk of terrorism had been known for years. Any airline executive understands that hijackings and crashes tend to promote negative perceptions about the safety of air travel. Some might argue that the size

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and scope of the attacks dwarfed any previous incident and the government had to respond because the airlines could not possibly have been prepared for such an event. Yes, but one must also ask why the government, meaning the taxpayers, should be liable. Are taxpayers to be liable for all business risks that any firm might suffer in another massive terrorist attack? We think not.

With respect to the government shutdown of operations, Dokupil noted that in reality the Federal Aviation Administration's (FAA) order came after many airlines, American and United Airlines, for example, had voluntarily halted their own operations. It is likely that the other airlines would have followed suit given the events of that day. Left to their own devices, it is not clear how long they would have chosen to ground their own planes.

However, even supposing that they would have chosen to continue to operate, the total cost to the airlines was much smaller than what the government provided. John Samples of Cato's Center for Representative Government calculated a more realistic figure for the total losses incurred by the airline industry.[6] In fact, Samples's source for this number was the airline executives themselves. They estimated the losses from the four-day grounding at $300 million per day, or $1.2 billion. This amount, though certainly significant, is far less than the $15 billion in direct aid and loan guarantees.


Southwest Airlines

By guaranteeing, or cosigning, loans, government officials claim to know how much credit should available to struggling air carriers. To receive a loan guarantee a company was required to adopt certain reforms and to make certain management concessions.[7] These restrictions kept some firms away from the government's table. But the offer was good enough to entice others.[8] The criteria the agency adopted were designed to mimic those used by private lenders.

However, this effort was surely misguided. First, private lenders who risk their own capital are far more capable of assessing credit worthiness than government bureaucrats who risk taxpayer dollars. Moreover, it is superfluous for the government to create such an agency as the ATSB unless, of course, its aim is to provide credit at below-market rates. But in that case, the government's intervention into the market is sure to backfire eventually and leave taxpayers on the hook for the bad loans. There is a good economic reason why some of these companies cannot obtain more credit: they are poor risks and the likelihood of default is too high. For the government to intervene in such cases is simply foolish. Finally, even if the loans are paid off, the guarantees cost firms without government backing the opportunity to borrow scarce capital. Whatever those firms would have produced might have been valued more by consumers than the services of bailed-out airlines.

Low-Cost Challengers

An example of this faulty process is US Airways, the first airline to declare bankruptcy after 9/11. While under bankruptcy protection the company restructured its debt and received a cash infusion through an equity deal with the Retirement Systems of Alabama (RSA), a state agency. In exchange for several seats on the board and a 36.2 percent equity stake in the airline, the RSA invested nearly $240 million in the ailing company. The agency also invested an additional $260 million dollars in secured and unsecured loans.[9]

The investment by the RSA played an important role in US Airways' initial emergence from bankruptcy protection. The company also benefited from a $900 million federal loan guarantee and $800 million in cash payments. To get the guarantee US Airways had to provide collateral, which it did in the form of assets ranging from airport slots and flight simulators to spare parts and airplanes and engines.[10] Without all this help it is likely the airline would have been liquidated. But the financial restructuring did little to change the company's underlying problem: it can't compete effectively in the industry. This is a problem for a number of the old-line carriers.

While under protection, US Airways was turned down for loans by roughly 25 banks, and the company's debt was downgraded to "junk" status by the major credit-rating agencies. Why, then, did the ATSB approve a loan guarantee? Did the agency have better insight into the company's credit-worthiness? Obviously, the risk of lending to US Airways was simply too great for the banks. However, that risk becomes inconsequential with government guarantees. If necessary the American taxpayers could be forced to repay the loan.

Even before the 9/11 tragedy financial analysts had predicted a loss of $2.5 billion for the airline industry for 2001 because of the recession the nation was experiencing.[11] This problem was magnified, James Gattuso of the Heritage Foundation noted, by the stiff competition old-line carriers were facing from new low-cost entrants such as JetBlue and established discounters like Southwest Airlines, which had steadily gained market share for years. In their struggle to adapt to changing market circumstances, US Airways and the others were forced to reduce costs, renegotiate with their unions, and improve efficiency, or suffer additional losses in passenger traffic. Unfortunately, US Airways has not altered its business strategy enough. Adjustment is part of the market process, but government interference interrupts the process by allowing poor performers to hang on.[12]

Southwest Airlines

The history of Southwest Airlines is instructive. Southwest began operations in the early 1970s, and its presence in the industry has changed the face of passenger air travel. Unlike the old-line carriers, Southwest focused initially on the short-haul market. As James Ott and Raymond Neidl explain in their book on the company, the success of Southwest was driven by its business plan as an "aerial bus service."[13] Unlike many traditional airlines, Southwest avoided hub-and-spoke networking in favor of the point-to-point operations long provided by bus lines.[14] Its goal was to keep costs of operations as low as possible and allow for a wider variety of destinations by providing convenient scheduling in each city it served.

When Southwest entered the industry, fares were set by a government board and the large carriers did not compete on price. Furthermore, many had little or no interest in providing short-duration flights.[15]

Southwest had a different view. As the firm's founder, Herb Kelleher, put it, "[E]veryone would love to fly for 45 minutes rather than drive for six hours."[16] Kelleher recognized that the demand for short-haul markets was not adequately being served and that the company could supply those markets given the right business model. Thus it looked for suitable and lucrative city-pair markets in which it could fly from one destination and back with a full complement of passengers, turning around as quickly as possible. To wring out even more costs, the airline operated only one type of aircraft and provided passengers little more than modest refreshments. As Southwest has matured, it has added new cities to its schedule and is flying longer distances. However, the underlying business model remains the same.[17] As a result, Southwest can provide low-price service to a wide variety of destinations with nonstop and one-stop alternatives.

The success of Southwest is fundamentally relevant to any discussion of the airline bailout because it demonstrates the larger problem for many old-line carriers with their union albatrosses: most are just plain inefficient. Therefore, one might reasonably assert the bailout is not going to change the inevitable outcome. It will only prolong the agony and do so at taxpayer expense.

As evidence, consider that last year US Airways filed for bankruptcy a second time, only 18 months after receiving its initial bailout package. When US Airways again left Chapter 11 protection this past September, its merger with America West was announced. Under the terms of the merger, America West would take control of the ailing airline and add it to its own operation. Moreover, America West would provide a $12 million severance package to 11 US Airways executives and grant unsecured creditors 12 percent of the shares of the new company. New investors are providing $565 million in exchange for 52 percent of the company's shares. The remaining shares of the new firm will be held by existing America West shareholders. Old shareholders of US Airways will lose their entire stake in the airline. Thus RSA is out its $240 million investment, which had allowed US Airways to emerge from bankruptcy the first time.[18] One is left to wonder what kind of financial Russian roulette is being played here.

The idea that government should protect large companies from failure is readily accepted. However, as we've seen, success cannot be guaranteed. Delta, Northwest, and United, all recipients of government help, are in Chapter 11. On the whole, the evidence demonstrates that the government's bailout has failed because it does not address the real reasons that the old-line carriers are struggling. Federal aid is arguably delaying the inevitable. Allowing capital to flow freely, even if it is the result of business failure, is the best means of promoting economic progress.

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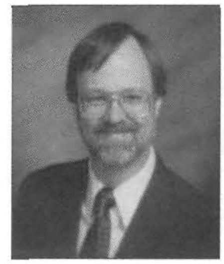
From Kleenex to Zippers: The Unpredictable Results of Entrepreneurs



BY BURTON FOLSOM, JR.

The 1920s was a decade that taught us many lessons in economics—perhaps foremost among them is that cutting tax rates encouraged entrepreneurs to invest in a variety of revolutionary products, from radios to refrigerators.

A corollary lesson, however, is also important: When entrepreneurs are turned loose and their property rights are protected, what they eventually produce can't be predicted—even by them. I want to describe four products that became part of American life in the 1920s—Kleenex tissues, the zipper, air conditioning, and Scotch tape.

> No planning board could ever have invented these products, much less figured out how to market them.

Kimberly-Clark developed the material in Kleenex tissues from wood pulp in World War I as a substitute for cotton, which was in short supply. Originally called cellucotton, it was first used in wadded form as a surgical dressing. Later in the war, in its modern tissue form, it was used as a filter in gas masks.

After the war Kimberly-Clark had large supplies of cellucotton on hand and the company searched for years for new uses for their product. Finally, in 1924 the cellucotton became Kleenex tissues. The marketing staff at Kimberly-Clark believed the tissues had a niche market for removing cold cream and other cosmetics. Endorsements from Hollywood stars such as Helen Hayes and Gertrude Lawrence promoted Kleenex as soft and efficient for cleaning their faces.

Fortunately for Kimberly-Clark, their marketers were wise enough to read their mail, and expand their market. Many letters from customers asked, "Why don't you ever say it's good for blowing your nose?" That led the company to do test-marketing—and yes, indeed, more customers preferred Kleenex tissues to handkerchiefs. In fact, the company now boasted that tissues were healthier because they were disposable. "Don't put a cold in your pocket" was the theme of the next wave of advertising. In 1929 Kimberly-Clark introduced the pop-up box. Sales grew further and were even strong during the Great Depression of the 1930s.

The zipper, like Kleenex tissues, had a variety of uses in its early years. Perhaps what is most surprising about the zipper, however, is that someone ever thought it up at all. The U.S. patent office was stunned by the product and hardly knew how to classify it.

Originally known as a "slide fastener," the zipper was first used on shoes. In 1914 one of its promoters, Gideon Sundback, finally produced a zipper that would consistently work. He called it "hookless no. 2" and during World War I sold several thousand for use on money belts for sailors. Sundback also sold some to the Navy for a "flying suit" it was developing. Garment manufacturers and tailors, however, preferred buttons and shunned the zipper.

Finally, in 1923 B. F. Goodrich took a chance and bought 150,000 hookless slide fasteners for its rubber galoshes. The company called their galoshes "Zipper Boots," and the name stuck. Only after that success did the textile industry explore the larger market for zippers on clothing.

The market for air conditioning seems obvious now, but it was not so at the beginning of the 1920s. Willis Carrier, its inventor, worked on air conditioning as a sideline at his job with the Buffalo Forge Co. in New York. Carrier was assigned to help a publisher in Brooklyn figure out how to stabilize the humidity in the printing room. Pages of newsprint expanded and contracted

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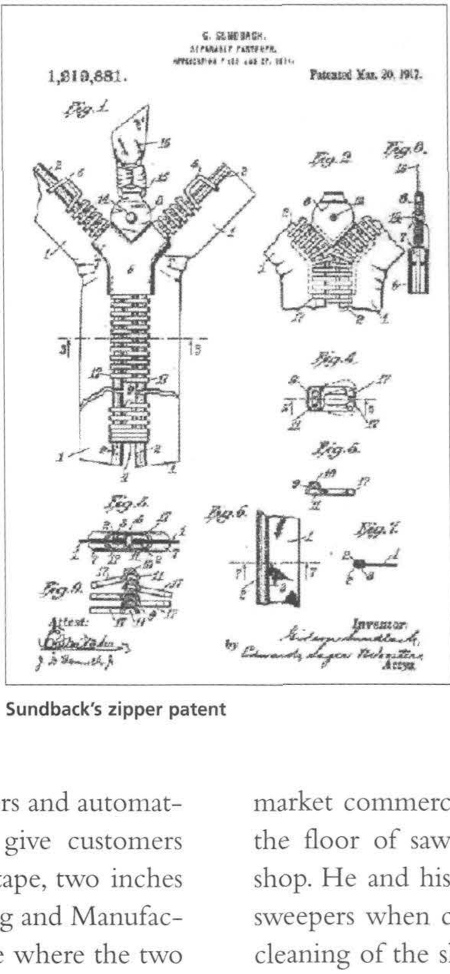
when the humidity rose and fell, and ink dried at different rates when the humidity changed.

When Carrier developed a system of air flows to dehumidify the print room, he ended up cooling the room as well. He had solved the newspaper issue, but was fascinated with the broader implications of producing "air conditioning" to cool and clean the air in stuffy buildings. His employers did not share his vision, and Carrier left to start his own company in 1914. His air-conditioning units were huge, cumbersome, and expensive, but he sold enough to acquire the capital to keep improving the product.

Carrier's big breakthrough came in the expanding movie industry. Most theaters closed down in the summer because the heat and stuffiness made patrons focus more on waving fans than watching the screen. In 1925 the Rivoli Theatre owners in Manhattan decided to install air conditioning to attract moviegoers in the summer. The patrons were enthusiastic; many were more excited over what was happening in the air than in the movie. By 1930 Carrier was supplying air conditioning to over 300 theaters in America. Factories soon followed, and finally, after World War II, Carrier was able to make home air conditioning units affordable and popular.



Sundback's zipper patent

Scotch tape was developed in connection with painting of cars. By the 1920s Henry Ford's all-black Model-Ts were out of fashion. Improved lacquers and automatic spray guns allowed automakers to give customers more appealing two-tone cars. Scotch tape, two inches wide, was invented by Minnesota Mining and Manufacturing (3M) to give the clear sharp edge where the two paint tones met. Before long, 3M was selling dozens of different types of Scotch tape for a variety of sealing purposes.

No Obvious Mass Market

These inventions had no obvious mass use or market when they were developed. Entrepreneurs had to invest energy and talent to figure out how best to sell their products, and ultimately consumers decided that Kleenex tissues were best marketed as disposable handkerchiefs, zippers as clothes fasteners, Scotch tape for household sealing, and air conditioning for home cooling. The common uses for these products seem obvious now, but that was not so in 1920. Trial and error, unexpected consumer interest, and sometimes desperation were part of developing these now popular, and seemingly indispensable, products. No planning board could ever have invented these products, much less figured out how to market them. Even their inventors were often mystified by the direction of consumer interest in them.

Perhaps we should not be surprised that so many new products of the 1920s were created for one purpose and ultimately marketed for another. Two inventions of the previous generation also fit this pattern. Josephine G. Cochrane, the daughter of a civil engineer, invented the dishwasher in the 1880s to protect her valuable china from being broken during washing by careless servants. Even when the sanitary value of a dishwasher was realized, its next market was large-scale cleaning for hotels. Popular home use didn't come until the 1950s, almost 70 years after it was invented.

Melville Bissell invented the carpet sweeper in the 1870s, not to market commercially, but simply to help his wife clean the floor of sawdust from packaging in her crockery shop. He and his wife only thought of marketing their sweepers when customers were more fascinated by the cleaning of the shop than by the cups and dishes being sold there.

Entrepreneurship is a strange and unpredictable process. We need it, and our lives have been improved by it. We must have strong property rights to sustain it. But what entrepreneurs will produce, and the marketing route they will take, will probably remain as strange and circuitous as it was in the 1920s.

U.S.-China Relations after CNOOC

BY JAMES A. DORN

When the China hawks in Congress joined forces last summer with protectionists, a strong (and dangerous) coalition formed to effectively end any hopes that CNOOC Ltd., a subsidiary of the state-owned China National Offshore Oil Company, would succeed in its bid to acquire Unocal. Indeed, after Congress amended the energy bill to require a lengthy review of the proposed takeover, China's third-largest oil company withdrew its $18.5 billion offer.

In a congressional hearing last July, Frank Gaffney Jr., president of the Center for Security Policy, told the House Armed Services Committee that the sale of Unocal to CNOOC "would have adverse effects on the economic and national security interests of the United States." He pointed to "the folly of abetting Communist China's effort to acquire *more* of the world's relatively finite energy resources," and warned of "the larger and ominous Chinese strategic plan of which this purchase is emblematic."

Such fears are evident in the flurry of anti-China resolutions and bills introduced by members of Congress. In June a nonbinding House resolution recommending presidential review of the CNOOC-Unocal deal passed by a wide margin. In a letter to President Bush, House Energy and Commerce Committee Chairman Joe Barton of Texas declared, "We urge you to protect American national security by ensuring that vital U.S. energy assets are never sold to the Chinese government."

Even without a legal prohibition on a deal, Congress can intimidate a foreign company such as CNOOC by imposing considerable costs on the takeover process and using the secretive Committee on Foreign Investment in the United States (CFIUS) to breed uncertainty. That is not to say foreign companies should have totally free access to the assets of U.S. companies. In some cases, especially in the area of sensitive technology with military applications, foreign investment might pose a legitimate risk to U.S. security. A government vetting process would then be warranted. In the CNOOC-Unocal case, however, it is difficult to find a credible threat. As energy economist Phillip Verleger said, "There's no national security issue here—zero. Unocal doesn't even have technology that needs to be kept secret."

There was no need for Congress to get involved in the CNOOC-Unocal transaction, or to amend the energy bill to require a separate investigation.

There was no need for Congress to get involved in the CNOOC-Unocal transaction, or to amend the energy bill to require a separate investigation. If a legitimate security risk existed, then CFIUS—a multi-agency panel chaired by the secretary of the Treasury and empowered by the Exon-Florio amendment to the Omnibus Trade and Competitiveness Act of 1988—could have addressed that issue and recommended presidential blockage. It is doubtful that the President would have agreed.

According to the June 24 *Wall Street Journal*, only 12 cases have reached the President's desk, and of those only

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one foreign acquisition was denied on national security grounds. With the bulk of Unocal's oil and natural-gas operations in Asia and with its U.S. production accounting for less than 1 percent of American consumption, it is difficult to see how the committee could have found credible evidence that the proposed takeover posed a threat to U.S. security.

Congress's latest attack on private property has come at the expense of Unocal shareholders, who lost at least $1 billion because of CNOOC's decision to drop its bid. In a letter to Unocal's board, Peter Schoenfeld of P. Schoenfeld Asset Management, which controls a block of the oil company's shares, wrote, "It is your duty to maximize value for stockholders." Indeed it is. But Congress inserted itself into what should have been primarily a market transaction—and in so doing became an overseer rather than a protector of shareholder rights. If Beijing wanted to provide cheap credit by using part of its massive foreign exchange reserves to help CNOOC purchase Unocal, that would have been a gift to American shareholders—not a concern for Congress or U.S. energy security.

By politicizing the takeover market and weakening the private property rights of Unocal's shareholders, Congress violated the very free-market principles it is supposed to uphold. Unocal was treated like a public asset rather than a private firm with the right to conduct its own business. Chevron, which merged with Unocal, is the clear winner, but Congress's confrontational approach could have serious implications for U.S.-China relations in the medium to long run. Specifically, the hawkish and protectionist stance toward China might embolden hardliners in Beijing, with the potential to fuel anti-American sentiment and crude nationalism.

The U.S. Trade Rights Enforcement Act (HR 3283), passed by the House in July, is yet another sign of growing hostility against the People's Republic of China and a prime example of using the PRC as a scapegoat for U.S. domestic problems. Although this Act is unlikely to become law, it is a step backward for U.S.-China relations. In particular, the Act "authorizes the application of the U.S. countervailing duty law to exports from nonmarket economies such as China."

Rep. Tom Tancredo of Colorado has introduced similar legislation (HR 1450) calling for "additional tariffs" on "any nonmarket economy country until the President certifies to the Congress that that country is a market economy." He would then earmark those tariff revenues for the "Social Security trust funds." This is the same congressman who argued that the CNOOC-Unocal deal "may seem small, but a few more deals like this one and America could find itself held hostage not just to the energy brokers in the Middle East but to China as well."

Congress's latest attack on private property has come at the expense of Unocal shareholders, who lost at least $1 billion because of CNOOC's decision to drop its bid.

Such anti-China hyperbole poses a serious threat to the policy of engagement and economic liberalization. China's private sector is now a large part of its robust economy and has given millions of people the opportunity to exit the state sector and escape poverty. Eventually, growth of the middle class will increase the demand for political reform to protect fundamental human rights. Indeed, this is already occurring, as seen by the recent amendments to the PRC Constitution that give greater protection to private property rights.

Yet American politicians on both sides of the aisle see China as a major threat to American jobs and view trade as a form of economic warfare, rather than as a mutually beneficial arrangement that increases the wealth of nations. Blocking trade with China will ultimately destroy jobs, not create them. Our future—and China's—will be brighter under what President Hu Jintao calls a policy of "peaceful development" than under a policy of protectionism and misplaced nationalism. As Federal Reserve Chairman Alan Greenspan said in his testimony before the Senate Finance Committee in June,

> In the decades ahead, it is in our interest and that of the global economy that China continue to progress toward becoming a more market-based, productive,

and dynamic economy in which individual initiative, not government decision making, is the fundamental strength behind economic activity. For our part, it is essential that we not put that outcome, or our future, at risk with a step back into protectionism.

A prime example of "a step back into protectionism" is Congress's threat to impose punitive tariffs on China if Beijing does not revalue the yuan by up to 27.5 percent (the so-called Schumer-Graham bill). Although that legislation has been delayed because of last summer's change in China's exchange-rate regime (from a pegged exchange rate to a managed float), many in Congress still feel that China is engaging in unfair trade practices by undervaluing its currency.

China's Socialist Market Economy

Congress is right to criticize China for its adherence to a "socialist market economy," but the PRC has moved steadily toward a real market system by removing barriers to trade and investment, and freeing most prices. We should recognize those gains while criticizing China's human-rights violations and the lack of a just rule of law. Even with China's shortcomings, however, Congress was not justified in interfering with the CNOOC-Unocal deal. As the Chinese Foreign Ministry said before CNOOC's pullout, "We demand that the U.S. Congress correct its mistaken ways of politicizing economic and trade issues, and stop interfering in the normal commercial exchanges."

> What China needs is less government and more markets. The surest way to achieve that result is to strengthen the policy of engagement.

Alarm over China's economic and military rise is often justified by reference to China's poor human rights record. The record is indeed poor, but it will not be improved by denying the Chinese people the right to trade, which itself is an important human right. Countries that are left outside the global trading system, such as Cuba and North Korea, have shown no interest in advancing human rights and have perpetuated poverty.

What China needs is less government and more markets. The surest way to achieve that result is to strengthen the policy of engagement, not to threaten China with protectionist measures under the guise of national security. Beijing will view Congress's interference as yet another attempt by the U.S. government to widen its power at the expense of China's development.

China's thirst for oil and natural gas has driven world demand upward and increased prices, and that trend is likely to continue. Over time, production and consumption will respond to higher prices as producers search for new supplies and consumers conserve and switch to cheaper alternatives. If the U.S. government interferes with the market process, future production will suffer and American energy companies will find it more difficult to operate in foreign countries.

Of course, if CNOOC were a truly private firm, Congress would not have been so concerned. China's challenge is to move more rapidly toward privatization and the rule of law. Future cross-border transactions will then be less costly and more successful, and U.S.-China relations will improve.

At the same time, Washington would be wise to heed the advice of Prime Minister Lee Hsien Loong who, in his July 12 speech to the U.S.-ASEAN Business Council, said that if the United States values its influence in Asia, it must take "a considered, long-term approach, upholding its commitment to free markets, free trade, and international rules." However, "if it yields to short-term political pressures and turns protectionist, the damage to U.S. interests in Asia and its standing worldwide will be long lasting."

New Labour's Persistent Retreat from the Free Market

BY NORMAN BARRY

As Britain's New Labour governs for an unprecedented third term in the United Kingdom, it is time to look back a little, at least as a way of modestly predicting the future. The obvious domestic question is: will capitalism and the market economy be any safer in the next five years than they have been in the last eight? Or will the subtle and blatant departures from economic freedom that have occurred in the first two Labour terms accelerate and will the country be under old socialistic Labour in everything but name? Tony Blair has said he will stand down as prime minister at the end of the next Parliament, but has the damage already been done? Will the likely succession of Gordon Brown be that much different?

Gordon Brown
www.thecommunitychannel.org

New Labour said it was different. In 1997 it claimed it had abandoned all that twentieth-century socialism. It changed its constitution to say that it had given up on the nationalization of the means of production and exchange even as a long-term goal for some state-planned utopia. It promised not to tax and spend, or persecute business. It had a prudent chancellor of the exchequer, Gordon Brown, who had all the Scottish parsimony and caution that would guarantee long-term prosperity. He was even born near Adam Smith's home. After the election of 1997 people believed him. I myself, for the first time in my life, went to bed thinking I would not wake up in the old East Germany under a Labour government.

To be fair to Mr. Brown, he began well. He gave the Bank of England its (de facto) independence so that interest rates would not be set to benefit the government of the day and monetary policy would not be the plaything of party politics. Equally important, Mrs. Thatcher's reforms, especially in relation to the trade unions and privatization, looked safe. Even big business was happy to cooperate with a Labour government, though we should have been warned—big business has always liked big government.

And the dangers were already there. They were just a little slower in coming round this time. Labour has always hated financial success. It thinks that wealth only comes from digging holes in the ground or bashing metal. So it slapped a retrospective, one-off £5 billion tax on those financial institutions that had made money out of Thatcher's privatization program. Worse still, the Labour government increased the tax burden on private pension funds to the tune of £5 billion a year forever. Reform of state pensions had been one of Margaret Thatcher's greatest achievements. She had inherited a costly long-term plan to provide earnings-linked unfunded pensions to the workforce, paid for by unwilling and unconsulted future generations. She unwound all this and managed to put the majority of the workforce in privately funded schemes. Compare this to social-democratic Europe, where there are riots every time the French government tries to introduce much-needed reforms to unsustainable pension promises.

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And on it went. Brown, chancellor of the exchequer and Blair's presumptive successor, became less prudent by the day and began to raise taxes that impinged on ordinary people as well as the rich. But he kept his promise not to raise the income tax, so nobody noticed the other 63 taxes he hiked, including a significant raise in National Insurance (aka social security) and the stamp duty on house purchases. In total, public spending is now 42 percent of GDP, up from 37 percent. There is a gaping hole of £14 billion in the public accounts, which is set to widen. And there are 800,000 more state employees, all Labour voters, doing useless jobs since 1997. So it really is the same old Labour, but with a different presentation. It at least got *that* from capitalism.

Brown likes to present himself as an adherent of Anglo-American capitalism, as distinct from the beat-up European social-democratic version. He has even written articles for the *Wall Street Journal* on those lines. But he is not to be believed. He is an old-fashioned socialist who taxes and regulates as much as the Europeans. He is a Euroskeptic, but like the old Soviets, he wants "socialism in one country": the United Kingdom. Blair has at least tried to reform the public services, against Brown's opposition, but has not succeeded.

Britain has probably the worst health-care system in the civilized world, evidenced, in part, by many preventable deaths from heart disease and cancer. The reason: it is entirely tax-financed with a monopoly supplier, the National Health Service (NHS). True, it is free at the point of treatment, but it is hard to get treated. Labour has poured billions of pounds into state medicine, yet there are still poor service and long waiting lists for operations. At least the Europeans have a complex social-insurance system, not as good as private insurance but better than general tax funding. And they have competitive suppliers too. That is why many Brits take vacations in Germany just to get ill. (There are reciprocal health agreements between member states of the European Union.) At least Blair tried to open up the closed UK system with the creation of foundation hospitals, independent of the NHS, which could raise their own funds. But the proposal was emasculated in Parliament, largely at Brown's behest.

Similar reforms were blocked in the education system, so that parents continue to have little or no influence on their children's schooling and the unions remain de facto owners and managers of the schools. Blair also worked hard to raise tuition for university students. It is a disgrace that rich parents should get virtually free higher education, and it is even more of a scandal that the Conservatives should support this inequitable system. Blair only just managed to get a small raise in fees passed after ferocious opposition from his own party and the self-seeking and opportunistic Conservatives. They represent too many rich parents with children in the state universities, which is all except one.

Failed Socialist Road or Complete Thatcher Revolution?

So the British should think carefully when they savor the Labour victory. Do they want to continue to revert to the failed socialist road or complete the revolution begun by Mrs. Thatcher? Since the Conservatives have not yet produced a new blessed Margaret, serious capitalists and free marketers were hoping for a big Blair victory last May. Mrs. Thatcher's successors have shown no interest in school choice, privatization of the health service, or serious tax cuts. So now it is Blair or real socialism. Blair needed a big victory to give him the confidence to fire Brown and save the country. He didn't get it, so it is socialism all the way under Brown when he takes over at the end of the next Parliament. Blair's own real flaw was his obsession with Europe and its new "Constitution," but it looks as if the British will get all that, whoever wins the battle for the leadership of Labour, New or Old.

Americans should think on the British experience. There is no feasible alternative to real capitalism. The "Third Way" is the Third World, where the United Kingdom is headed under Gordon Brown. He has positioned himself very well. While not dissociating himself from Blair's controversial pro-American foreign policies, he has been sufficiently distant so as not to offend Labour's traditionally visceral anti-Americanism. And in domestic policy he has consistently massaged Labour's millions of voters who live parasitically off the productive private sector. Labour won't nationalize anything much, but it will exploit the private sector and expand the government's role, especially in education and health. And taxes will rise.

Capital Letters

Do Models Yield Data?

In regard to the article by John Semmens on light-rail transit (June): there seems to be a blurring of the distinction between what has been observed as fact and predictions for the future based on models. It goes as far as referring to the numbers from the models as "data."

Models are just that—and no more. The output from them depends strongly on the assumptions made. And socioeconomic models are notoriously bad, e.g., the Club of Rome's doomsday predictions.

The table on "Impact on Daily Traffic" in Semmens's article is fanciful. I doubt seriously if the model used is accurate to two decimal places. But most important is that there has been no attempt to check the model's predictions. What is really given in the article is informed speculation covered up by numbers and pseudoscience.

I have worked in modeling physical and life sciences phenomena, both with NASA and for a major oil company. So I understand the strength and weaknesses of modeling. Good models depend on knowing first principles and having good data. Socioeconomic models tend to lack both of these.

—HENRY E. HEATHERLY
Lafayette, Louisiana

John Semmens replies:

Granted, models are only simulations that may or may not be borne out by future events. The point, however, is that the government agency promoting light rail—an agency with every incentive to "cook" the numbers to extract as favorable a forecast as possible—nevertheless came up with figures showing that light rail will actually worsen traffic congestion. Of course, this forecast was buried in the bowels of an official report to the Federal Transit Administration. The politicians touting light rail still claimed it was an answer to traffic congestion.

As for the tiny fraction of an impact, this is the scale with which we must deal with light rail. Though light rail costs billions to construct, its impact on travel choices is small in every city that has it. The Phoenix system was projected to carry two-tenths of one-percent of the travel. Many of these light-rail riders were expected to be displaced bus passengers. The net impact was projected to be the removal of one automobile out of every 2,500 from the region's streets and one of every 700 in the corridor served by light rail. These tiny impacts on the number of cars on the roads are offset by the reduction in street capacity that occurs when lanes that were to carry autos are torn out and replaced by light-rail tracks.

Forecasts aside, the actual experience with light rail where it operates shows that its impact on relieving traffic congestion is tiny and possibly negative. Given this record of non-attainment of the purported goals of light-rail systems, the investment of large sums of scarce resources in them does not seem warranted.

The critical error was committed when a decision was made to remove public transportation from the marketplace and put it under government ownership and operation. This combined with access to taxpayer subsidies has led to a spiral of enlarged deficits and diminutive accomplishments.

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Book Reviews

The Roots of Poverty in Latin America

by Guillermo M. Yeatts
McFarland • 2005 • 179 pages • $29.95 paperback

Reviewed by Richard M. Ebeling

Few things stand out in such stark contrast as the economic and social differences between the United States and the countries of Latin America. Since gaining its independence from Great Britain in the late eighteenth century, the United States has offered virtually unlimited opportunity for a growing population, along with a rising standard of living for practically everyone. The countries in Latin America won their independence from Spain and Portugal in the early decades of the nineteenth century, yet their societies, for the most part, have experienced far less of the economic prosperity and little of the wider political and personal freedom enjoyed by their neighbor to the north.

The contrast is even more peculiar when it is remembered that a good number of these Latin American countries emulated the constitutional order of the United States when establishing their own independent political regimes. Almost invariably, however, political dictatorships were soon combined with monopolies, privileges, corruption, and persistent poverty for the broad mass of the population.

And while the United States was torn apart by a destructive four-year Civil War in the 1860s, America's history since then has mostly been one of domestic tranquility and political stability. This stands, again, in dramatic contrast to the violent political regime changes that have occurred throughout Latin America in the form of civil wars and revolutions during the last two centuries.

Trying to explain this great difference between the United States and Latin America is the task taken up by Guillermo Yeatts in his recent book, *The Roots of Poverty in Latin America*. A native of Argentina, Yeatts is an economist by training and a successful businessman by vocation. He is also a devotee of classical liberalism and active in many free-market organizations in both North and South America (including FEE).

The United States, Yeatts explains, grew out of the British tradition of respect for the individual and his rights to life, liberty, and property. The rule of law, restraints on governmental authority and power, and belief in the value of freedom of trade and enterprise were the institutional ingredients at the founding of the American Republic. Indeed, at the heart of many of the grievances enumerated in the Declaration of Independence against the British Crown was the spider's web of mercantilist regulations, controls, and taxes that restricted the economic liberty of the American colonists.

The Latin American experience, Yeatts points out, was very different. Imperial Spain was an absolutist monarchy that exported all the worst features of a command economy and authoritarian political system to its colonies in the new world. Trade monopolies in agriculture, mining, and commerce were imposed throughout the territories under the sway of the rulers in far-off Madrid. Ruthless and corrupt imperial governors worked hand-in-glove with an imported and privileged aristocracy that claimed complete power over all whom they ruled, whether they were native Indians or colonists brought over from Spain or other parts of its world empire.

Every aspect of life in the Spanish American domains was rigidly regulated through price and wage controls, import and export regulations, and occupational and professional guild privileges. Positions of local political power were purchased from those higher in the chain of monarchical authority, and this power was absolute over those below. There existed no sense of "rights" as the British colonists knew and demanded them along the eastern seaboard of North America. There were only "duties" to fulfill, holders of power to be obeyed, and sundry privileges that were available for purchase and sale.

There were many attempts to establish more-enlightened regimes closer to the United States model. In the late nineteenth and early twentieth centuries, Argentina did so with great success, and was considered one of the leading "Western" economies around the time of World War I. But the cultural residues of the Spanish authoritarian past have, unfortunately, kept dragging the countries of Latin America back to the policies and practices of the "*ancien regime*." These forces were only reinforced throughout the twentieth century under the influence of socialism, fascism, and nationalism.

The 1990s, Yeatts says, did see reforms toward greater freedom and market opportunity that in fact brought economic and social improvements. But they were introduced only under the pressure of economic failure and earlier hyperinflations that had pushed these countries to the brink of collapse. But even as these reforms were introduced, the wider arena of "public policy" was dominated by an ideology of "rent-seeking" (the buying of favors and privileges from the government to avoid the pressures of market competition), and a pattern of democratic demagoguery that took the form of a flood of government spending and foreign-funded deficits to win the favor of "the masses."

Yeatts does not want his story to be one of seemingly total despair and pessimism. He believes that the forces of globalization will continue to pressure Latin America to adapt and become more open and competitive. He hopes that this will push these countries to practice greater fiscal and monetary restraint, as well as introduce a greater degree of rule of law and legal transparency.

But he realizes and emphasizes that ultimately what is needed in Latin America is a change in the political-philosophical underpinnings of these societies, away from their authoritarian past and toward the ideas and values of a classical-liberal society. He also knows this will not happen overnight.

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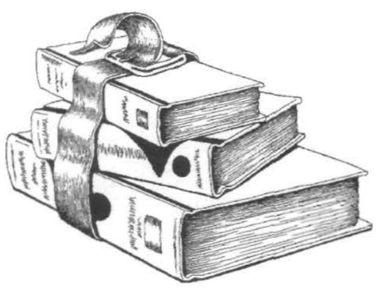
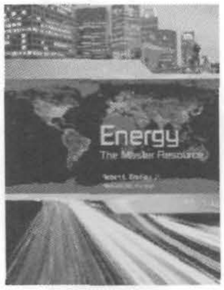


Energy: The Master Resource

by Robert L. Bradley, Jr., and Richard W. Fulmer
Kendall Hunt Publishing • 2004 • 228 pages • $19.95

Reviewed by George C. Leef



The economic and historical ignorance of the American public is frequently exploited by politicians and special-interest groups. The hotter the issue, the greater the exploitation, and no issue is hotter today than energy. Myths and misconceptions abound, leading people to embrace harmful interventionist policies. Ask a hundred typical Americans what role government should play in the production, pricing, and use of energy, and you'll probably be able to count on one hand the number who say "nothing."

In an effort to combat this widespread ignorance, Robert Bradley and Richard Fulmer, both of the Institute for Energy Research, have written a superb primer, *Energy: The Master Resource*. It is an attractive, colorful volume written to be accessible to a general readership. High-school teachers and college professors could easily incorporate the book into appropriate classes. If they do, they had better be prepared for a lot of student interruptions beginning, "Yeah, but I've heard that. . . ."

Bradley and Fulmer take on all the key energy issues. A good example is their discussion of climate change, where they employ facts to counter the relentless drumbeat of alarmism and demagoguery. The hysteria-mongers don't mention climate changes before the industrial era, but Bradley and Fulmer place our scientific knowledge squarely before the reader.

All right, but shouldn't we follow the "precautionary principle" and try to reduce greenhouse-gas emissions just in case the planet is in danger? Many people have been conditioned to accept that argument, but the authors refute it. They point out that reducing pollution isn't free. It consumes resources and has opportunity costs. "If those resources were used instead to create real wealth, countries that are now poor would be able to adapt to a changing climate. They could also be invested to develop technology capable of solving the problem far more cheaply and effectively," the authors write. The "green" approach would do little to affect the climate, but would have a drastic impact on the world's poor. Most Americans haven't considered that tradeoff, but the book makes it perfectly clear.

Speaking of tradeoffs, Bradley and Fulmer repeatedly observe that all energy sources have their costs. Many Americans are prone to become enraptured with "alternative" energy that seems able miraculously to solve our problems. "We should just switch to solar power (or wind power, geothermal power, ethanol, hydrogen power, and so on)," many people say after hearing a report extolling some particular source. The authors curb such enthusiasm by pointing out the inevitable tradeoffs. Regarding solar power, for example, the authors note that we would need hundreds of square miles of solar panels to replace the generating capacity of one nuclear power plant. And on that perennial favorite of vote-hungry politicians campaigning in the Midwest, they write, "Creating ethanol may consume more energy than is contained in the ethanol. This point is controversial, but probably cannot be resolved as long as the government subsidizes the production of the fuel. If producing ethanol on the free market yields a monetary profit, then it will likely yield a net energy profit as well."

Another crucial issue the authors discuss is energy sustainability. Widely publicized "We're running out!" scenarios have convinced many that we need immediate government action to promote "renewable energy sources." Bradley and Fulmer demonstrate that the only sensible policy is for the government to keep out of the energy market and allow capitalism to work. Rather than looking to politics, where decision-makers don't have their own money at risk and won't bear the cost of being wrong, we can and should rely on profit-seeking businesses to find the best ways of producing and distributing energy.

One of the problems that noninterventionists confront is that the opposition usually seems to hold the moral high ground. The various "green" organizations never stop posturing as altruistic defenders of Mother Earth against the onslaught of heartless, shortsighted free marketeers. Bradley and Fulmer do a considerable service in noting that the "green" organizations have their own fundraising interests at heart in promoting their doomsday outlook. Once people start to doubt that there's nothing but altruism behind those organizations, the moral high ground starts crumbling away.

The late Julian Simon called energy "the master resource" because it is crucial to our ability to do almost everything. Bradley and Fulmer have done a superb job of explaining the field. In the likely event that you know someone who is misinformed about energy issues, I recommend a gift of this book.

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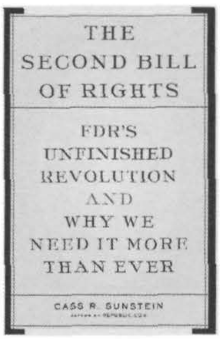
The Second Bill of Rights: FDR's Unfinished Revolution and Why We Need It More Than Ever

by Cass R. Sunstein
Basic Books • 2004 • 294 pages • $25.00

Reviewed by Michael DeBow



The problem with the American welfare state, according to Cass Sunstein, is that it is too small. In this book the widely respected University of Chicago law professor argues that the federal government should guarantee Americans a broad range of "economic rights." Sunstein organizes the book around the story of Franklin Roosevelt's 1944 State of the Union address. In that speech FDR argued for a "Second Bill of Rights" that would, he claimed, guarantee economic and social security to everyone. Roosevelt's second bill simply declared that "[e]very American is entitled to," among other things, a job and the "right to earn enough to provide adequate food and clothing and recreation," "a decent home," "adequate medical care," and "a good education."

Sunstein reworks Roosevelt's second bill a bit to come up with his own fuzzy blueprint. He notes that FDR was never interested in actually trying to amend the Constitution. Neither is Sunstein. Although he spends most of two chapters flirting with judicial activism as the way to expand the welfare state, he does not actually urge American judges to take up this task. Instead, Sunstein finally takes the position, near the end of the book, that we should "treat the second bill as a set of constitutive commitments, helping define the nation's deepest principles."

Unfortunately, the book is long on sentiment and short on substance. As a result, Sunstein fails to deliver on the second prong of the book's subtitle; he does not explain "why we need [a vast welfare state] more than ever." Indeed, he proceeds as if the case for it is simply self-evident. The entire book is predicated on the idea that the welfare state has worked, or can be made to work, well. The phrase "preaching to the choir" is fully applicable here.

Two problems with the book stand out: Sunstein does not flesh out his vision of a new and expanded welfare state, and he does not take seriously the problems plaguing the welfare state we already have.

As to the first, Sunstein explains, "I do not attempt to design policy initiatives here." Accordingly, he does not even hint at how much his new welfare state would cost, how high taxes would be raised to finance it, or what effect this would have on the private sector of the economy. Perhaps there will be a sequel in which all will be revealed. Failing that, his call for renewed enthusiasm for the welfare state seems unlikely to persuade anyone not already inclined to this point of view.

As to the second problem, Sunstein writes as if the last 60 years never happened. He has almost nothing to say about the shortcomings and negative unintended consequences of the federal government's social engineering to date. He avoids the fact that the welfare state we already have looks increasingly unsustainable. A recent government study of Social Security and Medicare estimated the present value of these two programs' funding shortfall to be roughly $72 *trillion*. No wonder many Americans—particularly younger people—today think of "social security" as an oxymoron.

The more generous welfare states of western Europe are in even worse shape than our own and are widely seen as a drag on European economic growth. Sunstein airily downplays these inconvenient facts by saying, "The experience in Europe, to the extent that it has been unsuccessful, offers a warning about means; it does not draw Roosevelt's ends into *the slightest doubt*" (emphasis added).

Ignoring Public Choice theory's inventory of the pathologies of politics and government, Sunstein asserts that "there is every reason to think that careful design [of new welfare programs] is possible." (This is buttressed by reference to the earned income tax credit.) A better illustration of the Nirvana fallacy is difficult to imagine.

For Sunstein, America's "so-called individualism" is "incoherent," laissez faire is a "myth," and arguments against a larger welfare state are "ludicrous," "silly," "almost comically implausible," and "jejune." Not surprisingly, Sunstein never considers the possibility that, because of the shortcomings of politics and government, the best way to promote economic well-being *just might be* by limiting government, thus indirectly promoting the growth of the private sector.

It is also no surprise that Sunstein holds to the left's conventional history of the Depression and the New Deal, or that he ignores the recent revisionist scholarship of Robert Higgs, Jim Powell, William Shughart, Gene Smiley, and others. In spite of this, Sunstein's rendering of Roosevelt's bizarre views on the American economy—FDR said Americans were under the thumb of a "new industrial dictatorship," for example—is grimly fascinating. Although certainly not Sunstein's aim, his description of Roosevelt's hostility toward American business may make the reader grateful that the effects of the New Deal were not broader and deeper than they have been.

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Meltdown: The Predictable Distortion of Global Warming by Scientists, Politicians, and the Media

by Patrick J. Michaels

Cato Institute • 2004/2005 • 271 pages • $24.95 hardcover; $16.95 paperback

Reviewed by Roy Cordato

Climatologist Patrick Michaels gives us a nontechnical and readable exposé of the "myths and facts" surrounding global warming. For skeptics of the mainstream global-warming hypothesis, that is, that dramatic, human-induced warming is occurring and will have cataclysmic effects if not checked by lifestyle-altering public policies, this book is a great read and an indispensable reference.

In chapter after chapter Michaels dissects the myths surrounding this hypothesis. He examines the alarmist claims regarding melting icecaps, extreme weather, species extinction, and more that are familiar to anyone who reads newspapers or watches CNN. This is done after an opening chapter that makes intelligible to the lay reader the basic science behind climate change.

What might surprise some is that Michaels, probably the best-known global-warming skeptic, accepts both the seemingly undeniable fact that the earth is warming *and* the proposition that it is in part due to human use of fossil fuels. As he states, "[G]lobal warming is real, and human beings have something to do with it." What separates him from the alarmists is his caveat: "we don't have everything to do with it; but we can't stop it, and we couldn't even slow it down enough to measure our efforts if we tried."

Yet Michaels denies that the warming will be either dramatic or will have catastrophic consequences. His position is thus more nuanced than his detractors are willing to acknowledge or many of his supporters realize.

Unfortunately, the most important chapter in the book is at the end. After dispelling all the myths about rising sea levels, melting icecaps, and the possible loss of penguins and butterflies, Michaels gets to the organizing theme of the book—namely, how government funding combined with university tenure leads to the distortion of science and bad public policy. Had this story been told at the beginning, the hyperbolizing of scientific claims, exposed throughout the book, would make more sense. Chapter 11 provides the lens through which the earlier chapters should be read. I suggest that readers start with this chapter and then go to the beginning.

By combining Public Choice theory with the ideas of Thomas Kuhn regarding how paradigms take hold in scientific research, Michaels explains why distortions in climate research should have been expected. (Note the subtitle of the book.) The dominant paradigm in the science of climate change includes the idea that "the major cause of recent climate change is the emission of carbon dioxide from the combustion of fossil fuel." Furthermore, scientists and statisticians through "improved quantification . . . will give policy makers . . . guidance on what might be required to slow, stop, or reverse those changes." Over time, a paradigm can be overthrown, but it must first be widely recognized as failing, and there needs to be a coherent replacement available.

Michaels states the alternative paradigm as follows: "We know, to a very small range of error, the amount of future climate change for the foreseeable future, and it is a modest value to which humans have adapted and will continue to adapt. There is no known, feasible policy that can stop or even slow these changes in a fashion that could be scientifically measured." Unfortunately it is not until this point (on page 222) that the reader is informed that "this book is about the resistance to this new paradigm."

Michaels explains how established paradigms, which are rarely challenged by the bulk of a profession, have "lives of their own." For most academic scientists, receiving tenure requires publishing in accepted peer-reviewed journals. These journals have editors and referees who are steeped in the dominant paradigm. Therefore, publishable research must ask only those questions that are generally accepted within it. Hence, the paradigm is perpetuated.

Layered on top of this is the "federalization of science," in this case the federal funding of climate-change research. Here is where Public Choice theory enters. It is not in the interest of NASA, DOE, the EPA, and other agencies to fund research that does not accept the dominant paradigm, which, by definition, will perpetuate a need for additional appropriations from Congress. This process stifles both research into and public awareness of the alternative paradigm. Government funding reduces the probability that the dominant paradigm, no matter how inconsistent with real-world data, will be overthrown.

Clearly, Michaels's book is a must-read for anyone interested in getting the straight facts about global warming. But this book is just as important for those who want to better understand the relationship between scientific research and government funding that lies behind it. Professor Michaels makes it clear that government funding of science can be dangerous to both our liberty and to the advancement of science itself.

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Economics for the Citizen, Part III

BY WALTER E. WILLIAMS

Someone might have made you a gift of *The Freeman*. Does that mean reading this article is free? The answer is a big fat no. If you weren't reading the article, you might have watched television, talked to your wife, or worked on your homework. The cost of having or doing anything is what had to be sacrificed. While reading this article might have a zero price, it most assuredly doesn't have a zero cost.

To reinforce the idea that price is not the full measure of cost, imagine that you live in St. Louis. The barber who cuts your hair charges $20. Suppose I told you that a barber in Charleston, S.C., would charge you $5 for an identical haircut, would you consider the Charleston haircut cheaper? While it has a lower price, it has a much greater cost. You'd have to sacrifice much more in terms of time, travel, and other expenses to get the Charleston haircut.

People often erroneously think of costs as only material things, but that which is sacrificed when a particular choice is made can include clean air, leisure, morality, tranquility, domestic bliss, safety, or any other thing of value. For example, a possible cost of a night out with the boys might be the sacrifice of domestic bliss.

Costs affect our choices in many ways, and for the purposes of this discussion we're going to assume that all the costs associated with a given choice are borne by the chooser.

Just about the most important generalization that we can make about human behavior is that the higher the cost of a particular choice the less of it will be chosen and the lower the cost the more of it will be chosen. This generalization underlies the law of demand. For simplicity let's assume price measures cost while we hold everything else influencing choice constant. The law of demand can be expressed several ways: the lower the price of something, the more will be taken; and the opposite is true of the higher price. We can also say there exists a price whereby one can be induced to take more or less of something. Finally, there's an inverse (reverse) relationship between the price of a good and the quantity demanded.

Why do people behave this way? The answer in a word or two is that people try to be as happy as they can. For example, if, when the price of oil rose, people simply ignored the price increase, they'd have less to spend on other things and be less happy. If they sought substitutes for the higher priced oil, they'd have more money left over and they'd be happier. That's why higher oil prices give people incentive to purchase more insulation, buy better windows, wear sweaters, and maybe move to a warmer climate. These choices, and many more, are substitutes allowing you to use less oil.

When people say a certain amount of one thing or other is an absolute must, that's like saying the law of demand doesn't exist and there are no substitutes. That's untrue—consider a diabetic. Can he do without 50 units of insulin a day? The law of demand says that at some price, say at a $1,000 a unit, he can. There's always at least one substitute for any good: doing without the good all together. In the diabetic's case, no insulin. While going without insulin has unpleasant consequences, it's a likely substitute at $1,000 a unit. You say, "Williams, that kind of economic analysis is cruel!" It's no more cruel than the law of gravity that predicts that if you jump off a skyscraper you're going to die. Both outcomes are unattractive, but it's reality. Indeed, tragically millions of our fellow men around the globe are forced to endure the unpleasant substitute for insulin.

There's a complexity to the law of demand that states: the lower the price the more people will take of something and the higher the price less will be taken. It's crucial to recognize that it's relative prices that determine choices, not absolute prices. Relative price is one

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price in terms of another price. Here's an example; actually it's a trick I pull on freshman students. Suppose your company offered to double your salary if you'd relocate to their Fairbanks, Alaska, office. Would you consider it a good deal and accept the offer? Some students thoughtlessly answer yes. Then I ask what if, on arrival, you find out that rents are more than double what you're paying now and the prices of food, clothing, gasoline, and other items are three and four times more expensive. The end result is that while your absolute salary has doubled, your salary, relative to other prices, has fallen.

A bit trickier example of how it's relative prices, not absolute prices, that influence behavior comes with the observation that married couples with young children who can't be left alone tend to choose more expensive dates than married couples without children. The couple's income and tastes have little to do with their decision; it's relative prices. Keeping the numbers small, say an expensive date, dinner and concert, has a $50 price tag and a cheap date, a movie, $20. The choice of the $50 dinner and concert requires that the married couple without children sacrifice two and a half movies that they could have otherwise enjoyed.

The married couple with children must pay a babysitter $10 whether they go on the expensive or cheap date. With the cost of the babysitter figured in, the dinner and concert will cost them $60 and the movie $30. In choosing the dinner and concert, they sacrifice only two movies. That date is therefore relatively cheaper for the married couple with children. Since it's cheaper we can expect to observe married couples with children taking more expensive dates when they go out. It doesn't take economic analysis to come up with this. A husband might suggest, "Honey, let's hire a babysitter and take in a movie." The wife explains, "That doesn't make sense. Since we have to pay $10 for a babysitter, whether we go on a cheap or expensive date, why not get our money's worth and take in a dinner and concert?"

Rising Coffee Prices

How about another example of relative prices? Suppose today's coffee price is $1 a pound and you typically purchase two pounds per week. You hear news that a freeze in Brazil destroyed much of its coffee crop and coffee prices are expected to soon rise. What would you do and why? I'm guessing you'd make larger coffee purchases now, but why? The average person would answer, to save money. That's an okay answer, but it doesn't tell the whole story. Once again it's the law of demand working. If coffee prices are expected to rise next week, that means coffee prices this week have fallen relative to those next week, and the law of demand says that when a price of a good falls people will take a larger quantity. It works in reverse as well. If coffee prices are expected to fall next week, you'd buy less coffee this week. Why? Coffee prices have risen this week relative to next week.

You might be tempted to ho-hum this coffee analysis as oversimplification, but it is the basic principle underlying the complexities of futures markets such as the Chicago Mercantile Exchange, where people, as speculators, become rich, sometimes poorer, guessing the future prices of commodities.

Our next lecture will see what the law of demand says about discrimination and other choices we make.

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Prepared by Beth A. Hoffman, managing editor, with the assistance of Kyle Jackson, FEE intern

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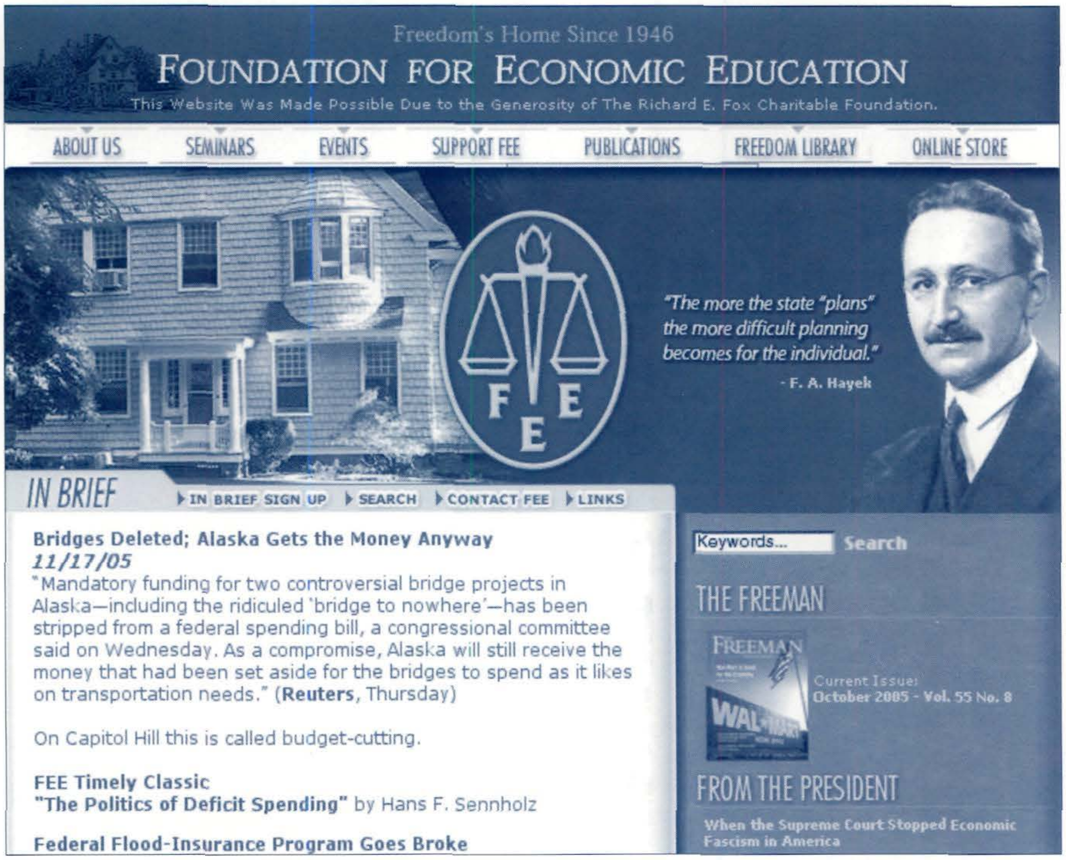

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The friendliness and charity of our countrymen can always be relied upon to relieve their fellow-citizens in misfortune. . . . Federal aid in such cases encourages the expectation of paternal care on the part of the government and weakens the sturdiness of our national character, while it prevents the indulgence among our people of that kindly sentiment and conduct which strengthen the bond of a common brotherhood.

—Grover Cleveland (1837–1908),
Veto message of February 16, 1887

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