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JULY 2000

IDEAS ON LIBERTY

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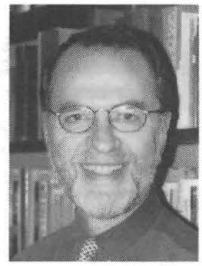
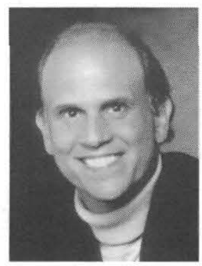
FEATURES



Paul Heyne



Michael Milken

COLUMNS

DEPARTMENTS

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PERSPECTIVE

An Asset That's a Liability

One of the things that make the free market (in Bastiat's felicitous phrase) the "prodigiously ingenious mechanism" it is also makes it vulnerable to destruction: people don't have to understand how it works. As long as they are free to pursue their own purposes in an environment where life and property are safe, the market will work. Participants do not need knowledge of, much less academic degrees in, economics. Economics is primarily a descriptive, or positive, science: economists study the consequences of what people do; people don't carry out the instructions of economists. To put it another way, there was economy before there was economics.

It is good that the market works that way. If people had to understand the market process for it to work, there would be no market process. How would the first market have gotten started?

But it's also unfortunate. Since people can accomplish their economic goals and even get rich without knowing economics, they have little incentive to understand the subject. (Much university economics does little to increase the incentive.) Such ignorance makes them susceptible to glittery notions that would scuttle the marketplace. Someone who has never contemplated the ingenious paradox of unplanned order is liable to think that all order is consciously arranged. That person won't bridle at schemes to "improve" on the market because to him the matter will be a choice between two plans, rather than between planning and no planning.

This suggests that it is good for people to encounter the idea of unplanned order early in life. The idea is accessible to children as young as ten years old, if not younger. I spent 15 weeks this winter and spring teaching basic economics to homeschoolers, ages 11 to 16. Beginning with the elements of human action and going all the way to the Microsoft case, those kids were able to follow the subject, and what's more, they enjoyed it. One of my most gratifying moments came midway in the course while I was discussing some aspect of the market. A girl in the front row riffled through her copious notes, raised her hand, and said, "It's an unplanned order."

I sleep a little better knowing that 20 kids who had not heard of Ludwig von Mises seven months ago now know who he is.

* * *

Economist Paul Heyne died in April. Thomas DiLorenzo pays eloquent tribute to this incomparable teacher and mentor.

The government wants Americans to stop smoking. But as Steven Yates explains, people—and the reasons for their habits—vary widely, making the blunt instrument of the state particularly bad at addressing the great tobacco issue.

The federal government has been paying to put more police on the street. Most people take as a given that more police are better. Really? James Payne dissents.

Advocates of market-based money are naturally interested when someone introduces an alternative, commodity-backed currency into the marketplace. Will it be viable in a world of fiat money? Will it be accepted? Lawrence White investigates.

The United Nations Conference of Trade and Development laments the increasing poverty of the least developed countries in this era of globalization. Tomas Larsson says hold the tears—UNCTAD is wrong.

In January Israel Kirzner criticized the supply-and-demand analysis of mainstream economists on grounds that they assume perfect knowledge for all market participants. This month James Ahiakpor says this is an unfair charge and Kirzner defends his position.

The issue of sweatshops has returned. Social activists call on government to crack down on employers who maintain low pay and poor working conditions for unskilled workers in the United States. Wendy McElroy points out that the real culprit is rarely mentioned: the U.S. Immigration and Naturalization Service.

People who fail to appreciate the market process often abhor some of its most valuable features. Case in point: corporate takeovers. How can something so important be so misunderstood? Norman Barry comes to the defense of the embattled corporate raider.

We've heard much about the poor record of the "whole language" approach to reading instruction. What is often overlooked is that this is not just a bad method of teaching children to read; it's also a program of political and social indoctrination. Patrick Groff lays out the agenda.

One hundred years ago this month, the late Gottfried Haberler, student of Ludwig von Mises, opponent of inflation, and champion of free trade, was born. Richard Ebeling describes his long and illustrious career.

Here's what our columnists have come up with this month: Donald Boudreaux shows how markets instill civility. Lawrence Reed seeks shelter from "great ideas." Doug Bandow looks at the latest survey of economic growth and economic freedom. Thomas Szasz sizes up the medical status of attention deficit/hyperactive disorder. Dwight Lee calms fears over the depletion of agricultural land. Mark Skousen proposes an alternative to "left and right." Walter Williams examines some silly ideas. And David Schmidtz, hearing claims that economic mobility is an illusion, replies, "It Just Ain't So!"

The reviews evaluate books on cosmic justice, history, federalism, economists, children, and taxes.

—SHELDON RICHMAN

by Donald J. Boudreaux Ideas

Markets, Politics, and Civility

"The teachable—those who aspire to an ever greater understanding—are those with an awareness of how little they know."
—LEONARD E. READ

In March, ABC Television presented "You Can't Say That!"—another illuminating program by John Stossel. In it, he documented the distressing intolerance that many Americans have for the opinions of others, and a corresponding acceptance of policies that infringe the freedoms of thought and speech.

In one scene, several students at Columbia University are shown contemptuously telling Stossel that they have the right to verbally obstruct Ward Connerly, an opponent of affirmative action who spoke at their school. Stossel asked these students who had given them the power to interfere.

"I'm taking that power, actually," was the answer offered by a young woman who was clearly proud of her and her cohorts' obstruction of what would otherwise have been a peaceful exchange of ideas between Connerly and other students who wished to hear him.

At first I was angry with these students. But my anger soon turned to pity. How sad that these students are so certain of their own omniscience. Being so cocksure will keep them from ever learning and growing.

I cheered myself by reflecting that these young people are unlikely to remain so convinced of their own omniscience. As soon as they must find jobs, each will quickly show more tolerance for others—the reason is that anyone who doesn't is unlikely to succeed professionally or even to retain any lasting friendships. Decent and productive people gain nothing by associating with those rendered uncivilized by their arrogance.

To succeed in life requires a general respect for others, a Socratic recognition that each of us is far more ignorant than informed, and a broad tolerance for opinions with which we disagree. Those who lack these traits never grow. Their mistaken belief in their own superiority shields them from learning. The ironic result is that those who are most sure of their greater wisdom and knowledge are far more foolish and ignorant than those of us who understand the limits of our own knowledge.

That these students will soon find it necessary to grow more humble heartened me.

"But wait," my thinking progressed. "What if they seek employment, not in the private sector where such arrogance is intolerable, but in some government bureaucracy shielded from competition?" I can well imagine any of these young people working as a regional administrator for the Department of Housing and Urban Development, as a staff attorney for the Equal Employment Opportunity Com-

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Donald Boudreaux is president of FEE.

mission, or as any one of a number of government functionaries who get to play god with other people's money and lives. Far from curing arrogance, such government jobs reinforce it.

Gratefully, we live in what is still largely an open society where most decision-making authority is decentralized. If I don't like the attitude of an employee, I can fire him; if an employee doesn't like the way I treat him, he can quit; if you dislike the deal that Radio Shack offers you on one of its radios, you can go to Circuit City; if Circuit City doesn't like the price you offer for one of its radios, it can offer to sell it to someone else.

Contrary to much popular wisdom, the ability of free people to make their own decisions unrestrained by government interference doesn't lead to arbitrary and capricious choices. Instead, each person outside of political settings improves his lot in life by acting in ways beneficial not only to himself but to those with whom he interacts. If I fire an employee for reasons that are purely malicious, I suffer. I lose a good employee and, in consequence, my profits fall. Other employers with more sense will line up to hire any good people whom I fire capriciously.

Focusing the consequences of decisions on those who make them—as the free market does so well—doesn't totally eliminate careless and malevolent behavior in private markets, but it surely keeps it to a minimum. More relevantly, it keeps such undesirable behavior scarcer than it would be if political decision-making supplanted private decision-making. Political decision-making is an especially fertile source of arbitrary and capricious decisions.

To see why, imagine one of these arrogant young Columbia students starting, say, a software firm. Perhaps in pursuit of her prejudices, she initially hires people based exclusively on their skin color. She soon finds her balance sheet in the red. If she has any sense at all, she overcomes her arrogance and learns. She learns that she must hire people according to their talent and not according to irrelevant characteristics. The market's requirement that she interact voluntarily with others compels her to grow smarter, more humble, more aware, more productive, more civilized. She becomes a better person. (If she refuses to overcome her arrogance, her continued business losses ensure that she won't long remain in a position to make important decisions.)

But now imagine this young woman, not in America, but in a highly centralized society—say, today's Cuba. Imagine her gaining influence with the party apparatchiks. For purely political reasons, she is given power to decide how thousands of people will live. Her success depends on pleasing only a handful of high government officials and not at all on her ability or willingness to act in ways that better the lives of the multitude of people subject to her authority.

Because ordinary people in such a centralized society are unable to remove themselves from her influence, she gets no meaningful feedback about whether or not her actions help or hurt them. And even if she did get such feedback, she could safely ignore it. Her position and power depend only on how well she pleases party bosses and not on how well she pleases the great majority of people whose lives her actions directly affect. In this setting, this woman will remain as arrogant, as imperious, as ignorant, and as uncivilized as she is as a student.

An important virtue of free markets is that they convert most arrogant, ignorant, and self-absorbed young people into modest, intelligent, and productive adults. A related virtue is that those few people who refuse to break the chains of their own ignorance never reap the full rewards of civilization.

My guess—certainly, my sincere hope—is that the overbearing students interviewed recently by John Stossel will, in time, grow civilized. If so, they'll look back on their behavior in college with embarrassment. But watch out if these students instead gain political power, for rather than civilize them, such power will cement their ignorance and prevent them from becoming productive members of civil society. □

Economic Mobility Is a Sham?

It Just Ain't So!

In "Why Decry the Wealth Gap?" (*New York Times*, January 24, 2000), W. Michael Cox and Richard Alm say the Federal Reserve Bank's latest survey of consumer finances showed, in a nutshell, that the rich are getting richer and the poor are getting poorer. Cox and Alm's response is: So what?

High school dropouts average $26,207, while workers with a professional degree average $127,499. Census figures show that many of the states with the widest income gaps have greater diversity in education levels. Twenty-six percent of those over age 24 in New York—the state with the greatest income disparity—have a college degree, whereas in Indiana, among the seven states with the lowest income disparity, only 16 percent do. Cox and Alm wonder, "Should we be lamenting that so many New Yorkers went to college?"

Another key factor, Cox and Alm note, is increasing immigration rates. Immigrants tend to cluster in low- and high-income groups. Thus it is no surprise that in the seven most unequal states, about 13 percent of the population is foreign-born. Among the seven states with the smallest income disparities, the immigrant population is only 3.8 percent. Cox and Alm conclude that America isn't a caste society, and studies that track individuals' incomes over time show that Americans have a remarkable ability to propel themselves upward.

A few weeks later, in "America's Rags-to-Riches Myth," Michael M. Weinstein (*New York Times*, February 18) responded. Americans, Weinstein says, "cling to the conceit that they have unrivaled opportunity to move up and, alas, down the income ladder." But the conceit, he says, is nothing more than that.

Weinstein is aware that a 17-year study of lifetime earnings by the Federal Reserve Bank of Dallas found that only 5 percent of people in the economy's lowest 20 percent failed to move to a higher income group. In a similar study by the Treasury Department, covering 1979 to 1988, 86 percent of Americans in the bottom fifth of income earners improved their status. But Weinstein dismisses such studies because many who moved up were students when the studies began. "This upward mobility of students hardly answers the enduring question: How many grown-ups are trapped in low-paying jobs?" Oddly, though, Weinstein asks this question as if Cox and Alm had no answer, but they do. Specifically, 5 percent of the poorest 20 percent don't move up. If Weinstein has reason to think the number is wrong, he gives no indication.

Weinstein rests his rather more gloomy conclusion on his reading of a study by Peter Gottschalk and Sheldon Danziger, who separated children into quintiles according to family income. Weinstein says, "About 6 in 10 of the children in the lowest group—the poorest 20 percent—in the early 1970's were still in the bottom income group 10 years later. . . . No conceit about mobility, real or imagined, can excuse that unconscionable fact."

Since Weinstein relies so heavily on Gottschalk and Danziger, I checked their study. They were looking at children five years of age or younger as their ten-year study began—ten years later they would still be classified as children. So, how upwardly mobile should we expect people to be in the first ten years of their lives? What we have is a cohort of mostly very young couples with babies, such that ten years later only 40 percent of them had moved into higher quintiles. Is that bad? On its face, it looks neither bad nor good. Note, though, that at the end of the study the parents were in their early 30s, still 10 years away from when they become most upwardly mobile. And of course the kids are 30 years away from when they become most upwardly mobile. What should we expect?

I myself would have been one of those kids they're talking about. I grew up on a farm in Saskatchewan. The farm failed when I was 11, and we moved to the city where my father became a janitor and my mother a cashier in a fabric shop. We moved up a lot, at least in absolute terms, during my first ten years. We got indoor plumbing when I was about three years old, for example. But we easily would have still been in the bottom quintile. Thirty-five years later, my household income is in the top 5 percent of the distribution. In my case, the problem with childhood poverty was not lack of money. Money was never a problem. Lack of knowledge was a problem. Lack of role models was a problem. (My parents received sixth-grade educations. I did not know what a university was until we moved to the city.) And I suspect that what was an obstacle for me remains an obstacle for poor kids today.

According to Gottschalk and Danziger, among children in bottom-quintile families that received welfare in the early 1970s, only 2.3 percent managed to escape the bottom quintile. Likewise, bottom-quintile children living in single-parent families had only a 6.4 percent chance of moving beyond the second quintile. But how can we be shocked that households with one adult generally bring in less income than households with two adults, and therefore will be found in the bottom quintile? How can we be shocked to find more income disparity in countries where single-parent families are more common? If there is a problem, surely it has nothing to do with income and everything to do with single parenthood (and I do not pretend to know how to solve that problem). According to Gottschalk and Danziger, there is a big difference between being poor and white and being poor and black. Blacks are more likely to stay at the bottom. I would not presume to quarrel with them on this point, and yet, according to Gottschalk and Danziger's own figures, "black children had a *higher* chance than white children of escaping poverty if they made the transition from a single-parent family to a two-parent family by the end of the decade (67.9 versus 42.6 percent)."

Gottschalk and Danziger say that between 1970 and 1980 the overall probability of a child's escaping poverty did improve, although the improvement was not significant. For the record, the probability of escaping poverty improved from 43.2 percent to 51.2 percent. If an eight percentage point swing does not count as significant, what does? Gottschalk and Danziger say the only group to show a "significant" improvement consists of "children in two-parent families." Their chance of escaping poverty improved from 47 percent to 65 percent. Now, recall that we are talking about the chance of escaping poverty before the age of 15. So what Gottschalk and Danziger's numbers are telling us is that about two-thirds of poor kids in unbroken homes escape poverty before they even earn their first paycheck. To me, such numbers suggest that it is a fact, not a myth, that we live in a land of opportunity.

What should we conclude? I conclude that there is no systemic problem of vertical mobility. The real problems are more specific than that. In general, poor people do move up. It is people from broken homes who have a problem.

—DAVID SCHMIDTZ
University of Arizona

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Paul Heyne, R.I.P.

by Thomas J. DiLorenzo

Most Americans have probably never heard of University of Washington economist Paul Heyne, who recently passed away. That's a shame, for Paul was arguably the most effective economic educator in America for the past 25 years.

Most free-market economists consider Heyne's textbook, *The Economic Way of Thinking,* to be by far the most effective tool for teaching the principles of economics. During the 1960s and '70s that honor resided with *University Economics* by UCLA economists Armen Alchian and William Allen, whom Professor Heyne acknowledged as his inspiration. The approach of Professors Heyne, Alchian, and Allen differs significantly from the dominant mainstream approach, which is almost exclusively devoted to a mind-numbing rendition of technique after technique in which students are forced to more or less memorize hundreds of theorems, formulas, and diagrams. Students inevitably become lost in the fog of technique, and most of them are miseducated.

In contrast, Paul Heyne believed that principles of economics must be taught "as tools of analysis." This means first picking an *application* of economic theory (the minimum wage, trade disputes, merger waves, price controls, exchange rate fluctuations, traffic congestion, and so on), and then explaining the unique contribution that economic theory makes to understanding the application. Once a particular economic theory is introduced in this way, *The Economic Way of Thinking* applies the same theory to several other applications. Heyne believed this is the only way that students can truly learn not just economics but *the economic way of thinking.*

His book went through nine editions over the past 20 years, but was never quite a market leader. One likely reason for this is stated by Heyne in his preface: teaching people to think like economists requires one to become familiar with both current economic events as well as economic theory, and to be able to apply that theory to myriad contemporary issues. Most academic economists are, well, too lazy for that. They prefer instead to take the easy way out and just recite a theory or two a day, accompanied by elaborate diagrams and mathematical manipulations that they long ago memorized.

Popular in the Old Soviet Bloc

The Economic Way of Thinking became enormously popular in the former communist countries in recent years, and Heyne himself spent a considerable amount of his time as an invited lecturer before audiences of Russians, Czechs, Slovaks, Hungarians, Bulgarians, Poles, and Romanians, among others. These are people who "can't afford to spend time learning an economics that is merely intellectual aerobics," he explained in the preface to

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his eighth edition; they "need to understand how markets work and what institutions are essential if effective cooperation is to occur in a society characterized by an extensive division of labor."

That is exactly what *The Economic Way of Thinking* teaches and what most other textbooks fail quite miserably at. That is because Heyne's vision of what economics is all about has its roots in Adam Smith; the Austrian school economists, most notably Nobel laureate F. A. Hayek; and Nobel laureate James M. Buchanan (a fellow traveler of the Austrian school). To these men, what matters and what most ordinary people do not understand is the process of exchange: the process by which literally millions of people in society coordinate their plans through markets—as long as they possess the freedom to do so. How this process works "is the great puzzle that the economic way of thinking begins to resolve," and few people have ever done it better than Paul Heyne.

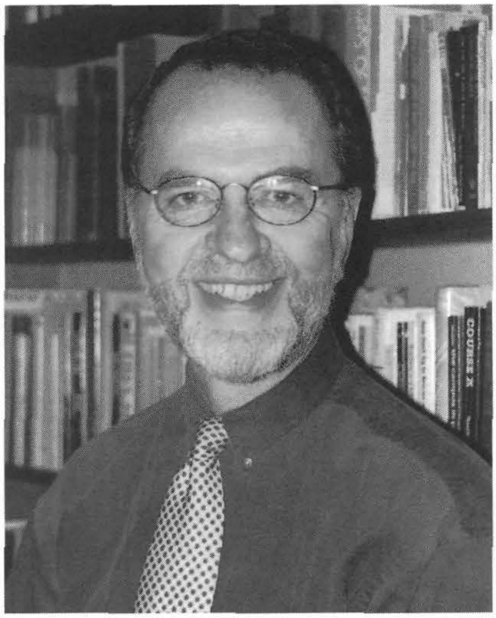
PHOTO CREDIT: LEON LAGMAY

Dr. Paul Heyne

Focus on Exchange

Focusing on market exchange through social cooperation and the division of labor—as opposed to mere "economizing" behavior, which is the subject of most economics texts—forces one to learn the importance of "the use of knowledge in society," the title of the most famous essay by Hayek, whom Heyne greatly admired. This has significant implications for the study of economic theory and policy. For example, to Heyne the corporate takeover market is a mechanism that, among other things, tells us which kinds of corporate structures succeed and which do not. Indeed, allowing corporate restructurings to take place is the only way to gain such information. By contrast, too many other economists (and especially non-economists), because they fail to understand this straightforward point, condemn the takeover market as wasteful and call for regulation.

The Economic Way of Thinking also explains why such "middlemen" as real estate agents, stockbrokers, and speculators, who are generally reviled by the politically correct, are in fact indispensable to the smooth operation of markets. The beneficial role of speculators, Heyne wrote, is to "even out the flow of commodities into consumption and diminish price fluctuations over time."

Paul Heyne devoted the last 40 years of his life to teaching economics to students all over the world through his lectures and his outstanding textbook. His legacy to the economics profession is to have helped revive the study of markets as they should be studied: as institutions that facilitate, in Adam Smith's words, "man's propensity to truck, barter, and exchange," and not as an endless array of "optimization" problems and puzzles that are quickly forgotten. □

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ON LIBERTY
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Why the War on Smoking Will Fail

by Steven Yates

Everyone knows that smoking is a risky business, health-wise. Cigarettes have been linked to many diseases and conditions, from lung cancer and heart problems on down. One of the first bits of advice a doctor gives a patient who smokes is to quit. Although not everyone suffers ill health from smoking—there are cases of people who chain-smoke for decades with few if any apparent health problems—the preponderance of the evidence is that cigarette smoking damages one's health over the long run.

Does it follow from this that governments ought to declare war on smoking? Should those who manufacture and sell cigarettes to willing customers in an open market be sued for billions of dollars?

Before answering this question straightaway, let us make an obvious point. If smoking damages one's health, then it does make sense to work at encouraging smokers to quit and to discourage teenagers from starting. How do we do this?

The first thing to note is that no one ever kicked the habit permanently who was forced to do so. This is equivalent to attacking the symptoms of a disease while leaving the disease's causes untouched. Government-suppressed behaviors will simply go underground where their dangers actually increase, not decrease (the situation with illegal recreational drugs in America). Making smoking illegal is obviously not a live option, as it would provoke a mass rebellion: the Prohibition-era crime wave would look tame by comparison! But expanded government can use the legal system in other ways. The most popular at present is to file suit, ostensibly to cover the costs of treating smoking-related health problems. Hence the "tobacco war."

If the aim of this "war" is less smoking, it is likely to fail.

The person who successfully quits must *want* to quit. No one can be forced to quit. Not really. Quitting smoking can be hard even for those who want to kick the habit. Many people try to quit many times. A number of approaches are currently used in smoking-cessation programs. The best involve carefully planned, systematic behavior-change efforts that make use of devices such as careful self-observation, diary-keeping, and so on. The would-be quitter may be asked to record the circumstances in which he smokes, or the moods that tempt him to smoke, the people he tends to be around, where he is when he smokes, and so on. The point is to understand as thoroughly as possible the situations that prompt him to smoke and then to address those situations. He may be encouraged to arrange new situations that don't involve smoking, find new friends if all his friends smoke, avoid the establishments where he smokes. He may be told to get rid of ashtrays and all other visible reminders of his habit. There may be actions he can take that are

Steven Yates has a Ph.D. in philosophy and recently received a master's in health promotion and education.

incompatible with smoking and can substitute for it. He may be asked to record his successes in his journal and what led to them. If he lapses—as most who quit cigarette smoking will do from time to time—he may be asked to record as many details as he can remember of what prompted the lapse. Where was he? Who was he with? What was he thinking about? And so on. In this way people can learn to control their behaviors instead of allowing their behaviors to control them. To be sure, there are people who quit "cold turkey" and never look back. But this is not the norm. Millions of people have quit smoking once they learned the health risks. For most, the process was arduous and strewn with lapses into the old patterns of behavior.

People Are Different

What makes serious smoking-cessation efforts more complex is that what is needed for success differs somewhat from person to person, because people are different. A technique that works well for one person might be totally ineffective for someone else.

Moreover, while millions have quit, millions more have also started during the same period. Despite government-imposed warning labels on every cigarette pack, cigarettes continue to sell briskly. Despite age limits for legally purchasing cigarettes, they continue to fall into the hands of teenagers who want them, whether they believe it will make them more "adult," more acceptable to their peers, or for whatever other reasons, which again vary from case to case. They aren't thinking about the long-term health risks. Although everyone knows about these, they just aren't a priority for everyone.

Many libertarians openly defend a person's right to smoke if that is their informed choice. The challenge is to the unstated premise that if X is unhealthy behavior, then X ought to be fought by the government to the greatest extent possible, and banned if possible. Accepting this premise is what separates "health nazis" from genuine health promoters. The latter have some insight into human complexity. They know that many factors can motivate people to smoke, and that quitting is rarely a matter of sheer will power. They also recognize that laws, lawsuits, and top-down mandates have a poor track record.

Reforming Oneself

All the science we have on smoking cessation points in a single direction: it must begin at the bottom—where the individual smoker is, in the situations the person actually confronts in life—and proceed upward. It must begin with the person's sincere desire to quit and willingness to do, on a personal level, whatever it takes.

Force doesn't work. It will only exacerbate the problem by encouraging resentment and rebellion, and not addressing those factors that lead people to smoke or doing what needs to be done for them to quit. Ironic as it sounds, the government's war on smoking may well be a stumbling block to serious anti-smoking efforts.

The message (lest there be any doubt) is sound: don't smoke! If you don't smoke now, don't start. If you do, consider quitting. But this message can't be forced on anyone. It cannot be the basis of a workable and effective top-down policy. It is remarkable that the best findings in scientific health promotion are very much in line with the conclusions of those who believe that decisions, transactions, and so on, within society should be voluntary and not coerced. □

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Do We Really Want More Policemen?

by James L. Payne

Curt Oldfield of Bonner County, Idaho, has perhaps the most unusually decorated car in the nation. It's a 1986 Oldsmobile covered with 200 license plates carefully shaped and riveted to the hood, fenders, and doors. It's driven mostly in parades and auto shows, but one day his daughter, lacking transportation, took it downtown. And a Bonner County sheriff's deputy gave her a $43 ticket.

Oldfield vows to fight the ticket as a violation of his right to free expression, and perhaps he'll eventually win. But the conflict points up a larger problem with law enforcement that affects the whole country. For several decades, a "tough on crime" mood has gripped the nation. It led to the re-establishment of capital punishment and to a sixfold increase in the size of the prison population. It has also produced an increase in the number of policemen. Between 1980 and 1996, the number of sworn law-enforcement officials jumped 40 percent, to 738,000 (the figure includes 74,000 federal officers). And since 1996, numbers have been further swelled by President Clinton's plan to add another 100,000 officers.

At first glance, increasing the number of policemen seems to be a good way to fight crime, but few have stopped to consider the side effects of this policy. Once you've hired the personnel, they have to be busy, generating the paperwork that proves they are accomplishing something. It would be nice if this busyness were directed against the serious crimes that we worry about—and which were the reason for hiring the extra policemen in the first place. But unfortunately such crime happens out of sight, and policemen can't do much about it until after the fact. Therefore, to earn their keep, policemen have to go after the people they do see: our law-abiding friends and neighbors. They have to set up speed traps, pull people over for trivial offenses, and write tickets for people who decorate their cars in unusual ways.

The police aren't the only ones to blame. The harassment has been facilitated by thoughtless legislators who have crammed the statute books with a vast number of minor offenses, so that practically everything is now against the law, from buying cigarettes if you are under 21, to not having an approved whistle in your canoe. Who would have imagined, for example, that lawmakers would have made it an offense to display more than one license plate? This was the crime that Oldfield committed by decorating his car with license plates.

Another fallacy in the idea of using more police to stop crime involves the problem of recognition. Criminals do not wear sweatshirts with "Bad Guy" printed on them to enable policemen to single them out. One way police try to find robbers and murderers is to stop and question ordinary people who have done nothing wrong. Increasing the number

Contributing editor James Payne is working on a book about the history of the use of force.

of policemen therefore means an increase in the number of innocent people who will be harassed and intimidated by officers.

It also means an increase in the number of innocent people shot by police. After all, policemen aren't perfect. Some fraction of the time they will use their weapons inappropriately, shooting at ordinary people like you and me out of anger, fear, or just through carelessness. Statistics on the aggressive use of force by police are hard to come by because law-enforcement agencies sweep these incidents under the rug. In 1998, the *Washington Post* undertook an eight-month investigation of the D.C. police department's use of excessive force during the preceding five years. It found that the police had fired their weapons in 54 incidents, killing nine and wounding 19 people, all of whom were unarmed. The well-known case of Amadou Diallo, an innocent, unarmed black man gunned down by four New York City policemen in 1999 is just the tip of the iceberg. Police shoot at scores, if not hundreds, of innocent, unarmed Americans every year. Increase the number of policemen, and you increase the number of these deplorable incidents.

Hiring lots of policemen may be a way to get tough on crime but, as Curt Oldfield and many other Americans are discovering, it's also tough on decent, creative people who are just going about their business. □

IDEAS ON LIBERTY
JULY 2000

A Competitor for the Fed?

by Lawrence H. White

About a year ago I received a phone call from an entrepreneur named Bernard von NotHaus. He was eager to tell me about a new private currency, backed by silver, that he had designed and that his nonprofit organization is issuing. I was naturally skeptical, but being a student of private money, I agreed to get together with him at a local pub when he came through town. (It's often easier to argue monetary economics over a beer.) His outfit is called NORFED—short for the National Organization for the Repeal of the Federal Reserve Act and the Internal Revenue Code—and von NotHaus is an affable spokesman for the project.

Since October 1998, NORFED has been issuing American Liberty Currency (ALC) as a private alternative to Federal Reserve notes. The business magazine *Forbes* (April 3, 2000) has publicized the project, reporting that $230,000 in ALC is already in circulation. NORFED also sells one-ounce Silver Liberty pieces (for legal reasons, these are not called "coins," but for all practical purposes they are privately minted coins). Von NotHaus also calls his product line "the New American Dollar," which seems appropriate enough given that the original dollar was a silver coin. He likes to call today's government fiat dollar the "Federal Reserve Accounting Unit of Denomination." You can figure out the corresponding acronym.

NORFED's currency project offers an innovative approach to monetary reform. For most of us, the Federal Reserve's unlimited discretion over monetary policy is like bad weather: we complain about it, but few of us do anything about it. Why *don't* we do anything about it? Largely because we imagine that securing a better money means trying to rally massive political support for fastening a constitutional or legislated rule on monetary policy. Personal sacrifices in that direction seem unlikely to have a big personal payoff. Your expected personal payoff seems higher from taking the policy regime as it is, and simply trying to shelter your own assets from the vagaries of inflation and business cycles.

A silver-backed currency with widespread acceptance would provide a useful alternative to the Federal Reserve's product. Then, if you don't like the way the federal government manages (or mismanages) the value of the fiat dollar, you aren't limited to complaining. You can switch to the private alternative.

A Monetary FedEx

In a news story in *Coin World* (October 19, 1998), von NotHaus compared his organization's effort to the introduction of private alternatives to the U.S. Postal Service: "Federal Express brought competition to this heavily subsidized government agency that no one thought could change. . . . NORFED emulates

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this model by bringing a superior product to America's monetary system, its currency." A similar statement appears in NORFED's brochures and on its Web site (www.norfed.org). Apart from having a beer with von NotHaus, the Web site is the best place to get all the operational details of the project. There is also a lot of what I consider theoretical nonsense on the site about the supposed horrors of "debt-based" currency and "usury," but we can ignore all that for the sake of focusing on the prospects for the currency project.

Does the American Liberty Currency have any chance of gaining widespread acceptance? Good question. It's prudent to be skeptical, but it's not prudent to be *too* skeptical or skeptical for the wrong reasons.

One *wrong* reason for dismissing the ALC is the notion that something identical has been tried before and failed. In the 1980s a Kansas City firm called the Gold Standard Corporation, in addition to selling gold and silver pieces, issued notes denominated in units of gold, and even offered transferable deposit accounts denominated in gold. Its advertising slogan was "put yourself on the gold standard."

But the marketplace did not move to embrace the gold-denominated media of exchange, and it's easy to see why. As Carl Menger's well-known theory of the origin of money teaches us, any seller prefers to be paid in the medium of exchange that is the most popular with other sellers. When the monetary unit that everyone uses is the fiat dollar, sellers of goods want to receive dollars, not gold, because it is only dollars that they know they can turn around and re-spend. The first Gold Standard Corporation customers who tried to spend gold-denominated notes around town in 1988 would have discovered almost no stores willing to accept them in payment. Customers of a firm currently offering gold-denominated accounts transferable through the Internet, E-gold (www.e-gold.com), face the same problem.

The problem is one of achieving critical mass. Unless an alternative currency is regarded as a *much* more stable store of value, people will be reluctant to accept it knowing that it just isn't as spendable as the incumbent currency here and now. (When the incumbent currency approaches hyperinflation, however, as in Russia today, alternative currencies do gain acceptance.) Gold-denominated payments are *incompatible* with the prevailing dollar-denominated payments network. A critical mass does not exist until the network of traders who do accept payments denominated in gold is large enough to make paying in gold about as convenient as paying in dollars, and therefore to make the network self-sustaining. Doesn't a new silver-backed currency face the same problem?

The American Liberty Currency cleverly avoids the obstacle of unit-of-account incompatibility by denominating its certificates in U.S. dollars. NORFED currently offers ALC certificates of $1, $5, and $10 denominations, and Von NotHaus has shown me a $20 prototype.

But wait: How can a currency denominated in U.S. dollars have its value "backed and guaranteed" by silver? At first glance, this is the most perplexing feature of the American Liberty Currency program.

Ten dollars in an ordinary checking account has its dollar value (though not its purchasing power) "backed and guaranteed" by being redeemable for a $10 Federal Reserve note (or a $10 entry on the books of the Federal Reserve, which is how one bank pays another when a $10 check is written against the account and deposited into another bank). Any bank that issues a checking account balance is obliged and stands ready to redeem it dollar for dollar. ALC redemption centers, by contrast, are under no obligation to buy back ALC certificates in U.S. dollars; they only offer redemption in silver.

The face of the $10 American Liberty Currency certificate reads: "Silver Certificate. This is a receipt for Ten (US$10.00) Dollars given in exchange for Title to One (1) Troy ounce of .999 Fine Silver. . . . Redeemable by Bearer on Demand." The back declares that the certificate is a "warehouse receipt for one (1) troy ounce of .999 fine silver." Thus a $10 certificate is redeemable for one ounce of pure silver. It is redeemable for silver at any of NORFED's 300-plus redemption centers around the country. The text of the certificate does not specify in what form the ounce of silver will be provided, but let us suppose (in line with what the NORFED Web site suggests) that the redemption centers stand ready to give a one-ounce Silver Liberty piece in exchange for a $10 ALC certificate.

Of course, a one-ounce silver piece is not necessarily worth $10 in the market, in the sense of what coin dealers stand ready to pay for it. From March 1999 to March 2000, the spot price of silver on the metals exchange (the wholesale price for unminted silver in bulk) largely stayed in the neighborhood of $5.00 to $5.50 per ounce. On the day this is being written the highest transacted price was $5.09 per ounce. Internet coin dealers on that day were offering to sell single one-ounce round silver pieces minted by private firms like Englehard and Sunshine for $5.49, or spot plus about 40 cents (they offered spot plus 29 cents in bulk), plus shipping and handling fees. They were bidding (were ready to buy them back for) an amount less than that. How much less? The dealer Web pages I looked at did not specify the bid prices for privately minted silver pieces (instead they said "call for price"). But clearly $5.49 is an upper bound for the current bid price of one-ounce private silver pieces.

Why Demand the Certificates?

Does NORFED then have any hope of maintaining a $10 value for a certificate redeemable for a one-ounce piece of silver? To answer the question fairly, we need to consider why such certificates might be demanded. There are basically three possibilities.

(1) If the certificates are demanded only as *tickets to obtain pieces of silver*, then they simply *can't* be maintained at a $10 value in the market when the silver pieces are selling for under $6. Recognizing this, NORFED forthrightly says to its potential clients: if your objective is to invest in silver, then buy silver, not our certificates.

It should be mentioned that the certificates promise one-ounce redemption at par for the next five years (fees may be imposed after that), so they do have some "option value." That is, they have an additional value over the current price of silver based on the possibility that a one-ounce piece of silver might go above $10 at some point in the near future, at which point it would clearly pay to redeem. But as a practical matter, the market currently considers this event so unlikely that the market value of the option is negligible.

(2) If only numismatic *collectors* demand the certificates, or people disgusted with the status quo who want to make a personal statement in favor of the hard money cause, NORFED faces a limited demand. The quantity of certificates demanded by collectors naturally declines with the size of the premium over the spot price of silver. It follows that the only way to keep the certificates at $10 is to keep them sufficiently scarce as collectibles.

The same logic applies to the possibility of keeping the Silver Liberty at $10 when other private one-ounce pure silver pieces are going for $5.49. By being the only seller of new Silver Libertys, NORFED can maintain the selling price at $10 easily enough, though it means selling very few Libertys when similar round pieces carrying the Englehard or Sunshine imprint sell for far less. But maintaining the selling price at $10 is not sufficient to maintain the resale value or market bid price of the pieces at $10.

A very different organization is pursing the scarce-collectible-plus-good-cause strategy in marketing its own dollar-denominated notes. The Antarctica Overseas Exchange Office, Ltd. (www.bankofantarctica.com), promotes its "Antarctican Dollar" notes as colorful collectibles and promises to contribute its profits toward preserving the continent of Antarctica. Although the NORFED's brochures and Web site do mention the collector value of its certificates, and although the face of each certificate does declare "the Bearer's First Amendment right to petition the Government for a silver based currency," this is clearly not the primary strategy NORFED wants to pursue. It is primarily promoting the certificates as an alternative *currency*, an instrument potentially useful as a medium of exchange. (The Antarctican Overseas Exchange Office, by contrast, frankly warns that its notes may be difficult to spend even in Antarctica.)

(3) Consumers living in our current fiat-dollar-denominated economy will demand American Liberty Currency *as a medium of exchange* only if the malls and grocery stores where they shop will accept the $10 ALC certificate at face value. The larger the group of such accepting retailers, the more useful ALC certificates are as currency, and the more consumer demand the ALC will attract. But typical retailers will accept the $10 ALC certificate at face value only if they can be sure of getting $10 worth for it in turn. Because nobody is obliged to redeem the certificate for $10, and because banks won't accept it, this means finding ways to spend it where it will be accepted as $10. Although the "informal" cash economy is large, deriving value from the certificates by spending them poses a serious logistical problem for "formal" retailers, who seldom use currency to pay wages or purchase supplies. Retailers routinely deposit most of their currency receipts in a bank account at the end of the day, and pay their workers and suppliers by check. If banks won't take ALC, neither will most retailers.

Acceptance is problematic even with the sort of retailer most likely to accept a non-bankable currency, a small business proprietor who can pocket and spend the currency that lies in his cash register at the end of the day. His decision on whether to accept the certificates at face value depends on whether he can find ways to spend the certificates at face value, which depends on how many other businesses are willing to accept the certificates at face value, and so on in a self-feeding circle. We have returned, in a slightly different context, to the problem of establishing a critical mass.

The NORFED Web site provides a list of small businesses that accept ALC; many of them are also redemption centers. Even if the list represents only one-tenth of the businesses that currently accept ALC, there are fewer than one thousand acceptors. Of course, even a growing network has to start somewhere. The challenge facing NORFED is to get the network of acceptors to grow.

The problem of establishing critical mass in a new market network, where the value of the good to each user depends on the number of other users, is not always insurmountable. After all, the world is filled with fax machines, even though there was very little use for the first two fax machines (their owners could only fax each other). The world is filling with DVD players and DVD-format movie discs, even though the incentive to buy a DVD player depends on the number of DVD movie titles available, and the incentive to make a movie title available in the DVD format depends on the number of DVD players bought. Because of the advantages their technologies offered, fax machine and DVD manufacturers were able to persuade early adopters that their networks *would* achieve critical mass. (For discussion of how entrepreneurs can jump-start new networks, see John Hagel III and Arthur G. Armstrong, *Net Gain*, Harvard Business School Press, 1997, or Kevin Kelly, *New Rules for the New Economy*, Viking, 1998.)

No Significant Advantage

NORFED's problem, to restate it, is to convince people to accept a $10 ALC certificate at face value on the supposition that other people will do the same, when most other people *do not yet* do the same. Does the ALC certificate offer any significant advantages over the established currency, the Federal Reserve note, the way the DVD format offers advantages over the videocassette? The fact that it is denominated in dollars (to provide unit-of-account compatibility) means that the ALC certificate offers no great advantage in prospective purchasing-power stability. For the foreseeable future, the purchasing power of ALC certificates is tied to that of Federal Reserve notes. The ALC certificate *does* have the one-ounce silver redemption option setting a lower limit to how far its purchasing power can fall—unlike a Federal Reserve note, which has no lower bound—but given current prices and expected inflation the silver redemption option seems financially irrelevant at present. (The futures market in silver is forecasting a spot price in the neighborhood of $5.40 per ounce in December 2000.) To become relevant, the price of silver would have to rise much closer to $10, or expected inflation rates rise sharply, so as to make "$10 silver in the near term" distinctly probable.

NORFED's literature emphasizes the superior anti-counterfeiting technology of its certificates. But the odds of being stuck with a counterfeit Federal Reserve note are small enough that few are likely to regard that as a large practical advantage.

I admire the courage of Bernard NotHaus in launching a private alternative to the federal government's currency. Economic theory and economic history indicate that currency is in fact best provided by private enterprise. But theory and history also indicate that, among private firms, banks are the most advantageous issuers of currency. Private bank-issued currency predominated around the world until government-sponsored central banks gained exclusive note-issuing privileges. Private banknotes still predominate today in Scotland and Northern Ireland.

Bank-issued currency provides full compatibility with the bank payment system. Unfortunately, the federal government has made bank-issued currency illegal in the United States. I have been told that the legal restriction has been lifted in the last few years, but (except for some very tentative trials of "prepaid cards" like Visa Cash) no bank has yet stepped forward to see whether the Federal Reserve will allow direct competition with its notes.

American Liberty Currency is fully legal, but unfortunately is not accepted by banks,

and won't be so long as it is not interchangeable for Federal Reserve dollars in the ways that checking account balances are, and so long as the Federal Reserve runs the interbank payment system. ALC certificates are thus at a serious disadvantage as a medium of exchange under the payment institutions that presently prevail. Because they don't *presently* offer a purchasing-power-stability advantage over Federal Reserve notes large enough to offset this disadvantage, I see little prospect of the American Liberty Currency catching on in a big way any time soon. But the situation could change. High inflation is not currently in the forecast (to judge by long-term interest rates), but nothing guarantees that it won't return. If it does, we might then find a very practical advantage in a silver-backed alternative to the free-falling Federal Reserve note. □

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Save Us from Great Ideas

I keep a "Pet Peeve" file. Among the many items it contains are several articles about a famous Michigan project that started out as somebody's "great idea." It secured government funds and then promptly went kaput. It was called "AutoWorld."

In 1984, the $70 million AutoWorld theme park opened in Flint, Michigan, amid much fanfare and hoopla. Situated on nearly seven acres of land downtown, the park was supposed to draw 900,000 visitors every year and help revive a dying inner city. It had the enthusiastic support of city and state officials and many big-name Flint citizens. Half the $70 million it took to build the facility came from federal, state, and city governments.

Sixteen years later, nothing remains of the park. Closed after less than two years of sparse crowds, and then later demolished, the site is now part of the University of Michigan's Flint campus. "Build it and they will come" turned into "Built it and they said ho-hum."

People who get "great ideas" and immediately think that government should bring them into being demean both their ideas and government. If an idea is really so great, why must force be employed? And if government is nothing more than a playground for every "great idea," then it ceases to be a protector of us all and becomes a weapon wielded by the politically well-connected at the expense of everyone else. This knee-jerk eagerness to get government involved in everything also has the effect of diminishing the important role of civil society's most civilizing institutions—the informal network of private and voluntary interactions that arise from families, friendships, churches, associations, and mutually beneficial commercial transactions in a free marketplace.

Every day, somebody somewhere gets a great idea and thinks nothing of stealing from others through government to fund it. Those of us who are troubled by these trigger-happy statists need to become more active and vocal in exposing their schemes. Toward that end, I share here a story and a letter.

Another Theme Park

With echoes of the AutoWorld failure still reverberating, the city of Kalamazoo is attempting to put taxpayers on the hook for another theme park. The city-funded Kalamazoo Aviation History Museum has announced plans to build a seven-acre "Legacy of Flight" attraction—an aviation entertainment and education center slated to open in June 2003. Local leaders want the state of Michigan to come up with as much as half of the estimated $80 million construction cost. Proponents are pushing for a 25 percent hike in the local hotel accommodations tax to raise the other half. When I raised objections, its main promoter and the head of the museum, Robert Ellis, wrote me a letter in which he questioned my motives. This was my response:

Lawrence Reed is president of the Mackinac Center for Public Policy (www.mackinac.org), a free-market research and educational organization in Midland, Michigan, and chairman of FEE's Board of Trustees.

Dear Mr. Ellis:

Thank you for your letter of February 28 and the invitation to visit the Aviation History Museum. When I have plans to be in the Kalamazoo area, I will give you a call.

My criticism of the "Legacy of Flight" museum is not of the project itself, but rather, of the public funding of it through taxation. On WKZO radio a week ago, I very plainly stated that I had no doubt that the project has many interesting and informative exhibits and that if indeed it does, it ought to be able to attract plenty of paying customers to make it worthwhile. Nonetheless, since my position has prompted you to question my motives, I'd like to explain those motives to you here.

I have one motive for my position and it revolves around individual liberty and the proper role of government. If I were to concede that it is proper for government to take money from people (through taxes, which are not voluntary) for the purposes of entertaining and informing them about flight, then I suppose there is absolutely nothing that I could legitimately declare to be beyond the bounds of government. We could simply announce that government will rob Peter to pay Paul any time Paul gets a great idea.

America's Founders knew that everybody has his own ideas about what's good for others. But they also understood that just because you've got a "great idea," you don't have the right to compel other people to pay for it. The Girl Scouts have a great idea, but they sell cookies to raise money; they don't swipe it through taxes. I happen to think the Mackinac Center is doing fantastic, invaluable work but it would never occur to me to ask the politicians to tax somebody to pay for it. If state tax money goes to the Legacy of Flight, I wonder what you'd say to Grandma over in Bad Axe [Michigan], who will never visit it and has trouble paying her monthly electric bill, but who will be forced to pay for it anyway.

I am aware that people who want tax money for the Legacy of Flight project are absolutely convinced that it's different from similar government ventures in the past, like AutoWorld. What else is new? That's what the AutoWorld folks said. The real test of just how different it is, however, is not rhetoric. The real test is, Will people freely support it, or does it require compulsion (taxes) to make it fly?

How about if I make you a deal? I promise not to try to get politicians to take anything from you for any local projects I get excited about, if you promise not to try to get politicians to take anything from me for the projects that excite you.

American society is increasingly becoming one in which, figuratively, we are all standing in a circle with each person's hand in the next person's pocket. I think it would be courageous and principled of you if you were to declare, "I have such confidence in the Legacy of Flight project that I am going to convince people freely of its merits. I will persuade them to support it instead of taking their money through taxes whether they like it or not." You'd be a hero, and even the Girl Scouts would look up to you in admiration.

. . . I enclose for your reading a terrific essay entitled "Not Yours to Give." It's a true story of how Congressman Davy Crockett, over 150 years ago, changed his mind about using government to get by force what one is unwilling to convince people to give by free will.

Sincerely,
Lawrence W. Reed

Read "Not Yours to Give" on our Web site, www.fee.org.

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Stick to the Facts, Please

by Tomas Larsson

"The Least Developed Countries 1999 Report" recently released by the United Nations Conference of Trade and Development (UNCTAD) in Bangkok paints a grim picture of the effects of global economic liberalization on the world's 48 poorest nations.

Wrongly so.

"Whilst the 1980s were dubbed the 'lost decade' for developing countries in general and LDCs in particular," the report's authors state in the introduction, "the 1990s have become, for LDCs, the decade of increasing marginalization, inequality, poverty and social exclusion. The violence and social tension which afflict several LDCs are caused, in part at least, by increasing deprivation and inequality."

It is not hard to find out that UNCTAD is flogging a dead horse. Just turn to the statistical tables included at the end of the report. Let me highlight a few of the findings there.

Per capita GDP (in 1997 U.S. dollars) rose from $163 in 1980 to $235 in 1997. That represents a whopping 44 percent increase for the average inhabitant of the world's poorest nations, ranging alphabetically from Afghanistan to Zambia.

Progress has occurred at an astonishing pace also in other areas during the past 20 years. Secondary-school enrollment rose from 15 to 19 percent of the relevant age groups in the LDCs. That's a 26 percent rise. The number of radio receivers rose from 50 to 116 per 1,000 inhabitants—an increase of 132 percent. The number of daily newspapers in circulation rose from 5 to 7 per 1,000 inhabitants—a 40 percent increase.

In other areas, progress was less rapid, but no less important to the societies and individuals concerned. Between 1980 and 1997, mortality rates dropped from 116 to 108 per 1,000 live births in the LDCs. Food supply rose from 2,050 to 2,145 calories per capita per day. The primary-school enrollment ratio rose from 66 to 70 percent of the relevant age group. Obviously this leaves much room for improvement, but it is nevertheless clear that things are moving in the right direction.

Similarly, it is hard to find any evidence that the poorest countries are increasingly marginalized in terms of access to financial capital. Total financial flows to the LDCs rose from $10.441 billion in 1985 to $15.099 billion in 1997, measured in current U.S. dollars. The payments these countries had to pay to service their debts fell marginally—from $4.589 billion in 1985 to $4.374 billion in 1997. But more important, the debt-service ratio (debt service/exports) fell from 29 to 13 percent in the same period.

The devilishly glum picture painted by the UNCTAD report does not do justice to the real situation in the poorest of the poor countries. Things are bad—but the most important thing to keep in mind is that they are actually getting better.

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It is sad that UNCTAD uses all its extraordinary rhetorical powers to project such a dark and pessimistic view of the developing world. One negative effect may be that the poorest countries lose investment and export opportunities. What companies would be so foolhardy as to try to build up long-term investment and trading relations with countries that UNCTAD, the supposed trade and development expert, is declaring unmitigated socioeconomic disaster areas?

Lost Credibility

Another negative effect is less direct. The blatant exaggerations by UNCTAD regarding the situation in the least developed countries result in a loss of credibility. This is a fatal flaw in an organization whose very purpose is to produce research and analysis on trends affecting trade and development in the developing countries. This lack of nuance and credibility also makes it hard, if not impossible, for UNCTAD to be persuasive when it counsels against protectionism by the rich countries against the poor.

That the official spin on the issues was so easily swallowed by the press that covered the UNCTAD X conference only goes to show that journalists have stopped reading anything but press releases and that they pay scant attention to that old journalistic virtue of getting the facts straight and presenting them in a balanced manner.

Do the leaders of UNCTAD believe that these nasty little untruths and half-truths about the effects of globalization somehow serve a higher purpose?

Poverty would have ceased to be a problem a long time ago if it could be eliminated by misleading rhetoric. Now it is time to try something new: stick to the facts, not the prejudices. □

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Israel Kirzner on Supply and Demand

by James C.W. Ahiakpor

Israel Kirzner misrepresents mainstream economics by his assertion that in explaining market price determination by supply and demand curves, it always assumes "perfect competition," worse yet, perfect knowledge.[1] "The mainstream textbook approach . . . is, in one way or another, explicitly or implicitly, based on the assumption of perfect knowledge" and in which the "market-clearing price is *instantaneously* (or, at least, *very* rapidly) established." In contrast, "the Austrian version of the law [of supply and demand] *avoids* reliance on any presumption of universal perfect market knowledge (a presumption that . . . pervades much standard economics)."[2]

Mainstream economics uses the upward-sloping supply and downward-sloping demand curves simply to reflect the basic self-interested pursuit of net gains by market participants: sellers looking for higher prices in order to offer more quantities for sale per unit of time, and buyers looking for lower prices in order to purchase more quantities per unit of time. All such bargains are made by the market participants with as much knowledge as they may possess, but there is no insistence on complete or perfect information on the part of sellers or buyers.

Thus to say that there is an upward-sloping market supply curve for "capital" or savings in the financial market simply means that people or financial institutions would be willing to offer more funds on loan if offered higher interest rates. Similarly, to draw a downward-sloping demand curve for "capital" or savings is to suggest that more loans would be taken by borrowers if they were offered at lower interest rates. It is from such contrary tendencies of lenders and borrowers that classical and neoclassical economists explain that the rate of interest is determined by the supply and demand for "capital" or loanable funds (an explanation many Austrians fail to recognize[3]). The same model of supply and demand may be used to explain the determination of wage rates in different occupations or rental rates in different housing markets, but without invoking the assumption of perfect knowledge.

Few mainstream economists believe that the model of price determination in a "perfectly competitive" market is a satisfactory representation of real market situations, and few invoke the assumption of perfect knowledge. Rather, they consider oligopolistic and monopolistic competition as the norm. As George Stigler points out, "it seems improper to assume complete knowledge of the future in a changing economy. Not only is it misleading to endow the population with this gift of prophesy but also it would often be inconsistent to have people foresee a future event and still have that event remain in the future."[4] Several textbooks now talk about price-taking firms rather than perfectly competitive firms. Paul Samuelson and William Nordhaus, after teaching the perfect competition model and without invoking the assumption of perfect

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knowledge, also remark, "By the strict definition, few markets in the U.S. economy are perfectly competitive," and "If you look out the window at the American economy, however, you'll find that such cases [of perfect competition and complete monopoly] are rare; you are more likely to see varieties of imperfect competition between these two extremes. Most industries are populated by a small number of firms competing with each other."[5]

Marshall and Mill

Classical economists and such early neoclassical economists as Alfred Marshall also discussed equilibrium market-price determination by the forces of supply and demand but without invoking the assumption of "perfect competition." Thus, summarizing classical value theory, J.S. Mill notes that:

> if a value [price] different from the natural value [long-run average cost, including normal profits] be necessary to make the demand equal to the supply, the market value will deviate from the natural value; but only for a time; for the permanent tendency of supply is to conform itself to the demand which is found by experience to exist for the commodity when selling at its natural value. If the supply is either more or less than this, it is so accidentally, and affords either more or less than the ordinary rate of profit; which, under *free and active competition*, cannot long continue to be the case.[6] (emphasis mine)

Marshall talks about "free competition, or rather, freedom of industry and enterprise" and by "competition" means "the racing of one person against another, with special reference to bidding for the sale or purchase of anything."[7]

It is also well known that the modern perfectly competitive model is one in which firms or sellers do not compete—they can't change prices or product quality, two of the principal means of competition: "it is one of the great paradoxes of economic science that every *act* of competition on the part of a businessman is evidence, in economic theory, of some degree of monopoly power, while the concepts of monopoly and perfect competition have this important feature: both are situations in which the possibility of any competitive behaviour has been ruled out by definition."[8] Moreover, "the theoretical concept of [perfect] competition is diametrically opposed to the generally accepted concept of competition."[9]

For his strictures to be useful, Kirzner needs to justify his insistence that the use of market supply and demand curves to illustrate equilibrium price determination in mainstream economics always must entail the assumption not only of perfect competition but also of perfect knowledge. □

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1. See Israel M. Kirzner, "The Law of Supply and Demand," *Ideas on Liberty*, January 2000, pp. 19–21.
2. See Israel M. Kirzner, "Entrepreneurial Discovery and the Law of Supply and Demand," *Ideas on Liberty*, February 2000, pp. 17–19.
3. James C.W. Ahiakpor, "Austrian Capital Theory: Help or Hindrance?" *Journal of the History of Economic Thought*, Fall 1997, pp. 261–85.
4. George J. Stigler, "Perfect Competition, Historically Contemplated," *Journal of Political Economy* 65 (1) 1957, pp. 1–17.
5. Paul A. Samuelson and William D. Nordhaus, *Economics*, 16th ed. (New York: Irwin-McGraw-Hill, 1998), pp. 155, 170.
6. John Stuart Mill, *Collected Works*, vol. 3, J. M. Robson, ed. (Toronto: University of Toronto Press, 1965), p. 457.
7. Alfred Marshall, *Principles of Economics*, 8th ed. (Philadelphia: Porcupine Press, 1990 [1920]), pp. 10, 4.
8. Paul McNulty, "Economic Theory and the Meaning of Competition," *Quarterly Journal of Economics* 82 (4) 1968, p. 641.
9. S. Charles Maurice, Christopher R. Thomas, and Charles W. Smithson, *Managerial Economics*, 4th ed. (Homewood, Ill.: Irwin, 1992), p. 431.

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A Puzzle and Its Solution: Rejoinder to Professor Ahiakpor

by Israel M. Kirzner

I was at first puzzled by Professor James C.W. Ahiakpor's charge that I had misrepresented mainstream economics (by my statement that mainstream economics' use of its supply-and-demand apparatus relies on the assumption of perfect competition, and thus perfect knowledge). I was puzzled because mainstream textbooks are quite explicit on this point.[1]

Upon re-reading Professor Ahiakpor's comment, especially his quotations from Stigler and other mainstream writers who emphasize the unrealistic nature of the assumptions of the perfectly competitive model, and particularly its assumption of perfect knowledge, I believe that I can put my finger on the source of Professor Ahiakpor's misunderstandings. In fact, I will use several passages from Stigler's textbook on price theory (not the source of Professor Ahiakpor's Stigler quote) to attempt to clarify matters.

As a prelude to his discussion of how demand and supply determine price, Stigler carefully articulates the conditions (especially that of perfect knowledge) needed for perfect competition.[2] He then proceeds to address possible misgivings concerning these conditions. "If the reader bristles at the acceptance of assumptions such as perfect knowledge . . . he is both wrong and right. He is wrong in denying the helpfulness of the use of pure, clean concepts in theoretical analysis: they confer clarity and efficiency on the analysis, *without depriving the analysis of empirical relevance*. He is right if he believes these extreme assumptions are not *necessary* to the existence of competition. . . ." (Italics in original.)

Clearly, Stigler's position can be stated in three points: (a) the real world is not perfectly competitive; it is not characterized by perfect knowledge; however, (b) the economist is best able to explain price determination in the real world by referring to a "pure and clean" analytical model of supply and demand under conditions of perfect competition; and (c) this pure and clean model is then useful in understanding the real world because the degree of competition and of perfection of knowledge in the real world is sufficiently close (to the pure and clean concepts of the analytical model) as to render *that analytical model* a useful basis for understanding price determination in the real world.[3] Ahiakpor has focused exclusively, it seems, on points (a) and (c), and somehow concluded that *mainstream explanations for price determination do not depend analytically on perfect-knowledge assumptions.* But surely this conclusion is quite mistaken; point (b) can *not* be denied.

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For mainstream economics (and particularly for Stigler) the *applicability* of the pure and clean analytical model of supply and demand to the *real* world of imperfect knowledge is based entirely on the belief (hope?) that the degree of such imperfection in knowledge is not serious enough to compromise the applicability of the pure model. But the analytical basis for such application remains the pure and clean model itself. *Any explanation of real world price determination rests, in mainstream economics, on the validity of the explanation for price determination offered by the pure and clean model of supply and demand, under conditions of perfect knowledge.* The Austrian critique points out the internal, *analytical inadequacy* of that pure and clean model (quite apart from the unrealism of its assumptions).[4] As Hayek and the modern Austrians point out, the true explanation for the emergence of the market price refers strictly to *those very imperfections of knowledge that mainstream economists find it necessary to downplay.*

The Model's Uses

I would like to make a concluding observation. The asperity of Professor Ahiakpor's comment suggests that he has read my pieces as expressing complete dismissal of mainstream economics and as doing so with complete hostility toward it. This is by no means the case. Speaking strictly for myself (rather than on behalf of Austrian economists), I can say that there certainly are important uses for the mainstream perfect knowledge model. For many rough and ready purposes of applied economics, it is *this* model that is the most useful practical tool. I have often stated that if students had to be exposed to only one lecture in economics, I would hope that that lecture would be the mainstream supply-and-demand lecture. But, I must insist, such usefulness, *as a matter of pure science*, is severely limited. For adequate understanding of how markets work it is necessary to go beyond the perfect competition/perfect knowledge analysis, and to explore the *processes* that flow from imperfect knowledge and from the entrepreneurial decisions set in motion by such imperfection of knowledge. The truth is that recognition of this scientific insight turns out to be of utmost importance for developing enlightened public policy. For as Austrian economists know, it is in and through *these* processes that free markets make their contribution to human well-being. □

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1. I list here three examples, at different levels of sophistication: George J. Stigler, *The Theory of Price*, 3rd ed. (New York: Macmillan, 1966), pp. 87–89 (leading into his discussion of price determination through demand and supply); J. M. Henderson and R. E. Quandt, *Microeconomic Theory: A Mathematical Approach* (New York: McGraw-Hill, 1958), chapter 4 (and especially p. 86, leading into the discussion of market equilibrium in terms of supply and demand analysis); and D. Salvatori, *Microeconomics* (New York: HarperCollins, 1991), p. 26.

2. Stigler (p. 87) treats perfect competition as equivalent to the state in which each market participant faces infinitely elastic supply or demand curves—the state which corresponds to the price-taking assumption to which Professor Ahiakpor refers.

3. Many mainstream economists would follow Milton Friedman in arguing that the absence of realism in the assumptions of the perfectly competitive model is almost irrelevant to the usefulness of the model in predicting real world outcomes. For Friedman's well-known position on this see his *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953), pp. 14f.

4. It was Hayek who, in his brilliant 1946 critique of the perfectly competitive model, identified its central flaw as an explanation for price determination. The model cannot explain how price *comes* to be that which the model predicts. The model can only, given its assumptions, postulate that that *is* the price. The model *assumes* the result the *emergence* of which we are seeking to explain. See F.A. Hayek, *Individualism and Economic Order* (London: Routledge and Kegan Paul, 1949), pp. 93f.

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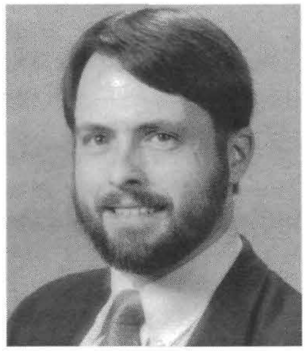

Economic Freedom or Foreign Aid?

In a world of plenty want abounds. To blame are big corporations, international trade, and open markets, according to demonstrators who have been attacking the World Trade Organization. In fact, they couldn't get it more wrong. Economic liberty and exchange offer the world's poor the best hope of a better future.

For most of the post-World War II period, developing nations shared the protesters' aversion to free markets. Countries throughout Africa, Asia, and Latin America chose state-run development strategies in an attempt to quickly bridge the yawning economic divide between rich and poor. The result was disaster.

Economies collapsed. Societies dissolved. Countries imploded. Small, wealthy elites emerged, while the mass of people languished. So foreign aid became the mantra. The United States alone contributed more than $1 trillion (in current dollars) to a variety of aid programs.

But, alas, that turned into another dead end. In 1996 the United Nations declared that 70 countries were poorer than they were in 1980; an astounding 43 were worse off than they had been in 1970. All were on the aid dole. Many of the biggest recipients of assistance—India, Sudan, Tanzania—were among the worst performers.

Indeed, there were few positive results to cite. The U.S. Agency for International Development admitted: "much of the investment financed by U.S. AID and other donors between 1960 and 1980 has disappeared without a trace." Similar has been the more recent experience with Bosnia, the Palestinian Authority, and Russia.

With the collapse of the argument that development depends on First World charity, Third World analysts looked elsewhere for answers. Resource endowments, population densities, and cultural attitudes all have impacts in particular cases, but none correlate with overall growth levels. Economic freedom does, however. The results of the latest volume of *Economic Freedom of the World*, written by James Gwartney, Robert Lawson, and Dexter Samida, could not be clearer.

The average income of people in the top fifth of economically free countries is nine times as high as that of those in the bottom fifth. The countries with greater economic liberty grew an average 2.27 percent annually last decade; those with the least economic freedom shrunk by 1.32 percent a year. People in the most free nations live 20 years longer than those in the least free states.

Hong Kong and Singapore tie as the most liberal economic systems. Both are particularly impressive examples.

Neither possesses natural resources. Both are relatively crowded urban areas. Neither collected endless streams of foreign aid. Instead, they opened their economies to domestic and foreign competition alike.

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Hong Kong has consistently topped the economic freedom list. Its government is small, its economy is relatively unregulated, and its currency and financial markets are free. Where Hong Kong lags—and fell significantly from 1995—is in the rule of law and enforcement of contracts. Nevertheless, despite China's takeover, the economy remains the envy of the world.

Singapore bests Hong Kong in the rule of law, and matches it in open currency and financial markets. However, its government is bigger and its regulations are more intrusive. Number two to Hong Kong throughout the 1990s, Singapore gained a share of the number one spot by holding its rating steady while Hong Kong slipped.

New Zealand, ranked number 32 in 1985, zoomed to number 3 a decade later and continues to hold that position. It has reduced government spending, dramatically deregulated its economy, and freed its currency and financial markets. There may be no better example of the way policy reform can transform economies than New Zealand.

The fact that the Asia-Pacific hosts the top three nations helps explain the region's remarkable growth. In a sense, Asians have conducted a dramatic experiment on the impact of economic liberty. The successes include Australia, which scores 7–8 (indicating a tie), and Japan and Thailand, which land in the top 21.

The region also shows what not to do. Some of the high-flyers that have suffered economic turbulence of late would benefit from an extra dose of economic liberty. For instance, Malaysia hits 37–39, South Korea ranks 47–48, Indonesia is at 49–50, and China comes in at 75–77.

Then there are the three leading powers in South Asia, Bangladesh, India, and Pakistan, which are abysmal, ranging between 86 and 96. Myanmar comes in at the very bottom, at 123 (insufficient information was available to rate all nations).

The United States ranks number four. America does well regarding freedom of currency and financial markets. Its standing on economic regulation is anemic, however, and government spending and subsidies are higher than those of Hong Kong, Singapore, and New Zealand.

Obviously, such market imperfections have not prevented the United States from growing dramatically and steadily. But America would get an extra spurt—and solidify past gains—if it addressed its policy shortcomings, mild though they are compared to those of so many other nations.

Europe, like Asia, provides an interesting mix. Great Britain, transformed two decades ago by Margaret Thatcher, runs fifth. It was 33 in 1975 and 16 in 1980. The government is still too large, but the economic role of state enterprises has shrunk dramatically. Marginal tax rates are lower, monetary policy is more stable, and trade barriers are down.

An economic tiger of more recent vintage is Ireland. A decade ago Dublin ranked 28. By 1995 it was up to six, its present position. Ireland has freed up its economy, cut taxes, deregulated its financial markets, and opened access to the international economy.

Also in the top dozen are Luxembourg, Netherlands, and Switzerland. Following closely are Denmark, Belgium, and Spain.

But then the reason for Europe's ongoing economic problems become evident. Its poorer performers lag in their protection of economic liberty. Germany comes in at 22–24. Austria, France, and Sweden follow at 25–30. Italy runs 31–34.

Greece comes in at an anemic 42–46, along with Hungary, the first former communist state to appear. The Czech Republic follows, with Estonia, Latvia, and Lithuania limping behind. The first Balkans nation, Slovenia, appears at 70–74.

Every other former East Bloc state trails even Haiti. Latin America tends more toward the middle, but still exhibits some range of ratings.

The bottom half of the rankings is filled with African states. Until the African people protect economic liberty, they are likely to remain poor.

Economic Freedom of the World offers an important lesson: The path to prosperity is simple—liberty. □

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Sweatshops: Look for the INS Label

by Wendy McElroy

The nineteenth-century phenomenon of sweatshops is re-emerging as an important 21st-century issue for American labor and business. For example, the United Students Against Sweatshops has called on its 180 campus affiliates to organize and force universities to deal only with manufacturers who abide by fair labor practices. In February, students from the University of Pennsylvania staged a much publicized sit-in in front of the president's office to ensure that the logo apparel sold by the university was not produced by sweatshop labor.

Although the students admitted that they had no evidence that any apparel had been produced by sweatshops, they thought it was "a safe assumption." The university agreed to withdraw from the Fair Labor Association, which students called "an industry-controlled monitoring system that only serves to cover up sweatshop abuses" and "a public-relations operation designed to improve the image of its members, like Kathie Lee Gifford and Nike." Instead, the university agreed to join the Worker Rights Consortium—a human rights and labor organization that advocates the "rights" to a living wage and to unionize in the Third World. But labor activists quickly point out that sweatshops exist in America too. Indeed, they seem to be a growing trend. A "Garment Enforcement Report" (April-June 1999) from the U.S. Labor Department reported that 205 sweatshop investigations resulted in the discovery of 109 violations.*

In the Austin *American-Statesman* (February 27), journalist Martha Irvine offers a typical account. Irvine begins by focusing on the harsh labor conditions of a tortilla factory on Chicago's South Side, then goes on to report the wider findings of the Center for Impact Research. "More than a third of the 800 workers questioned—many of them immigrants—described conditions in factories, restaurants and other workplaces that the federal government would deem sweatshops." As a result of this report and ensuing publicity, the U.S. Department of Labor announced its intention to work with ethnic community groups in order to uncover abusive employers.

This is a common pattern in anti-sweatshop activism—stories of personal exploitation are coupled with thin statistical analysis, which collectively result in a superficial governmental response. Often, the abuse is real. Sometimes, it is hideous. Unscrupulous employers are always blamed—and with cause. Government is always the proposed solution, with disastrous results.

Few people seem to question one of the fundamental reasons that nineteenth-century sweatshop conditions exist in 21st-century America. Free-market advocates correctly point out that low wages are appropriate to untrained, unskilled workers and that many of the sweatshop conditions are no more than

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*See http://www.dol.gov/dol/esa/public/nosweat/garment15.htm.

what naturally occur in the lowest-paid strata of employment. But, arguably, the most important abuses—for example, an inability of employees to organize or to enforce agreements—are the result of government. In this the Immigration and Naturalization Service (INS) must bear particular responsibility. As one of the tortilla factory workers explained to Irvine, "Because they [laborers] don't have papers, the bosses think they can do what they want." Employees who are not authorized by government to work have little or no protection against employers who break contracts and coerce their labor through threats. Usually they threaten to turn employees or their undocumented family members in to the INS for deportation.

Papers proving a worker's eligibility for employment became mandatory in the United States under the Immigration Reform Control Act (IRCA) of 1986. IRCA requires employers to complete an I-9 Form for "new hires" in order to record the documents that establish the worker's employment eligibility. Immediately, undocumented workers became vulnerable to abuse. For example, if an undocumented employee protests a breach of contract, he (or members of his family) can be reported to the INS.

The relationship between undocumented workers and the big labor unions is more complicated. In 1986, the AFL-CIO vigorously backed IRCA, largely because it gives American workers an extreme advantage in the labor market. For over a decade, Big Labor watched contentedly as every employer—under threat of legal sanctions—filled out an I-9 form on every employee. Now powerful unions such as UNITE (Union of Needletrades, Industrial and Textile Employees) call for the repeal of those sanctions. AFL-CIO Secretary Treasurer Richard Trumka declares, "we are all illegals . . . in the eyes of Wall St." By this statement he links the interests of American laborers with those of undocumented immigrants, both of whom are the alleged victims of exploitative capitalism. Thus Big Labor demands additional regulation to prevent sweatshops. The regulations being demanded are designed to solve problems that the unions themselves helped to create through their former support of INS policies. To understand Big Labor's shift on undocumented workers, it is necessary to sketch some history.

Abuse Created by the INS

Requiring I-9 forms on every new worker soon became inadequate for the government to "protect" American labor. In 1998 the agency grew tired of needing grounds for suspicion to conduct background checks on specific types of employees. Thus began an experiment called "Operation Vanguard"—a fishing expedition within the meatpacking industry of the midwest. The INS subpoenaed the employment records of all meatpacking plants in Nebraska, then cross-referenced them against Social Security and other government databases to determine which workers had proper employment authorization. After the initial industry-wide audit, the INS followed up with additional audits at regular intervals to check on new hires. (The program has since been extended to other states, with the INS proposing to hire private firms to run the relevant background checks. Such firms would not be subject to the same restraints as governmental agencies.)

When a discrepancy appeared in a document, the worker in question was ordered to appear at an INS interview. In many, if not most, cases the discrepancy was the fault of the INS. "The information on these databases is notoriously bad," explains Josh Bernstein, senior policy analyst at the National Immigration Law Center. "And because the database is flawed, a lot of people who have employment authorization end up showing up as illegal."

Even if they are legal, many foreign workers decide to quit their jobs rather than be interviewed by the INS. "It's like an IRS audit, except imagine that you face the threat of going out in handcuffs," Bernstein says. Further, many legal workers leave their jobs because a family member is not documented, and so they don't want to undergo an interview.

Horror stories of INS abuses as well as negative memories of government in their home countries mean that many workers simply flee. Usually, they are forced to work off the books at less attractive jobs where they have no seniority and where the employer may know how much they fear the INS. For example, on May 5, 1999, INS agents arrived at an IBP meatpacking plant in Lexington, Nebraska, to question more than 2,000 workers. The INS had previously reviewed the plant's I-9s and had found 318 discrepancies. On the date of the interviews, however, 185 of the workers under suspicion had left. Of the remaining 133, one was arrested and one was fired. The INS sweep disrupted plant operations and terrorized hundreds of workers.

One INS tactic in particular is almost a formula for creating sweatshops. As a general part of its strategy, the INS has encouraged employers to become partners in the government's verification process. Employers are urged to use an electronic employment program called "Basic Pilot," a joint project of the INS and Social Security that lets employers check up on all employees by accessing government databases. Basic Pilot was first used in California, Florida, Illinois, New York, and Texas, but has been expanded.

Offering employers access to government databases is part of an INS strategy called "interior enforcement"—that is, the enforcement of immigration law away from the border. In the eyes of already fearful immigrant workers, the employer is now an arm of the INS. Indeed, workers-rights groups warn that the INS is using employers as enforcement agents. Of course, having incriminating information on an employee gives an employer a great negotiating advantage. Some unethical employers have exploited this advantage to the detriment of undocumented workers who no longer feel able to enforce contracts or complain of abuses. Workers who participate in a union can be reported to the INS. In essence, the INS has given employers a green light to create sweatshops.

Big Labor's Shift on Undocumented Workers

At its 1999 annual convention in Los Angeles, top officials of the AFL-CIO admitted having made a mistake in backing the IRCA. But the government harassment of immigrant workers is not what provoked Big Labor into changing its stance. After all, such compassion had not prompted the AFL-CIO to advocate the protection of immigrant labor in the past. Rather, Big Labor's concerns were twofold: First, union membership has been declining across the board for decades. In the 1950s, 35 percent of U.S. workers belonged to a union. Today, the percentage is close to 14. To hold steady at that level, unions have to recruit 400,000 workers a year. With union figures stating that one in ten workers is foreign-born, Big Labor has come to a tardy conclusion: immigrant labor needs unions.

Eliseo Medina, vice president of the Service Employees union, is more candid: the unions need immigrant labor. "I am . . . convinced that as the labor movement is the best hope for immigrants, so are immigrants the best hope of the labor movement." If unions are to thrive into the 21st century, they need to reconstruct their power base. Miguel Contreras, secretary of the Los Angeles County Federation of Labor, the country's largest labor council, agrees. "If we're going to organize LA, we have to organize immigrants."

The second reason for Big Labor's shift on IRCA is the upsurge in union-busting that has accompanied this measure. Especially in the area of agriculture, farm managers have called on the INS repeatedly to pick up undocumented workers who were key figures in union drives. For example, nearly 1,700 employees were fired from 13 apple-packing houses in the Yakima Valley of Washington state in March 1999. These businesses had been the targets of intense organizing by the Teamsters. By sweeping the apple-packing houses clean of workers with "discrepancies," employers also destroyed the rank-and-file leadership of the growing union. Arturo Rodriguez, president of the United Farm Workers, claims that Bear Creek Production Company, a California rose grower, arranged to have 15 percent of the union's members fired through an INS review of documents. "These are workers that have been here 15, 20, 25 years," he states, "have houses, have families, are in the educational system, have paid taxes, are members of their communities. They asked them to demonstrate their status in this country. And then they were evicted and lost their jobs."

Some employers have been more subtle. For example, when employees at a garment factory in California joined UNITE, foreign-born union members were called into the office and required to produce their documents over and over again for verification. Other workers picked up the clue. Union support declined dramatically. Ironically, the largest barrier to the AFL-CIO's recruitment of immigrant members and the organizing of new unions is the very law it championed in 1986—IRCA. No wonder labor councils and local unions across the nation are beginning to call for repeal of those aspects of the measure that make it illegal for an undocumented worker to hold a job. Frank Hurt, president of the Bakery, Confectionary and Tobacco Workers, had been a key voice in support of IRCA. He was dismayed by the unintended consequences that followed. "Instead, they [IRCA and the INS] arm employers with additional weapons. . . . They pit worker against worker, ally against friend, driving wedges between us when we should stand united."

On February 16, 2000, AFL-CIO executive vice president Linda Chavez-Thompson praised immigrant laborers. "Throughout our country's history immigrants have played an important role in building democratic institutions and vibrant new communities that enrich our lives." Then the Executive Council issued a resolution that declared, "The so-called 'I-9' sanctions process, which unscrupulous employers have systematically used to retaliate against workers who join together in unions, must be eliminated." This reversed a 1985 executive council resolution that called for the imposition of I-9 style sanctions.

Despite this cautionary lesson on how government regulation and monitoring of business harms workers, one of the remedies for sweatshops being sought by unions is more government regulation and monitoring. For example, UNITE applauded the February 7 announcement of New York City Council Speaker Peter Vallone concerning an anti-sweatshop bill he is sponsoring. The bill would prohibit the city from purchasing apparel—including uniforms for policemen—from manufacturers who do not disclose their locations and allow inspections. In some ways, Big Labor is manifesting the same knee-jerk response that Kathie Lee Gifford did on discovering that her Wal-Mart clothing line was being produced by sweat labor. Gifford went on a crusade to impose more laws on business. When New York Governor George Pataki signed path-breaking anti-sweatshop legislation in 1996, he stated, "In no small measure, this bill is going to be signed this afternoon because Kathie Lee Gifford and Frank Gifford made this a personal crusade." The legislation holds liable manufacturers and retailers who knowingly purchase, ship, or deliver goods produced by sweatshops. Such legislation will do nothing more than drive labor practices further underground where abuse can flourish unseen.

In the end, it will be the marketplace—not legislation—that determines the value of labor and the working conditions laborers will accept. The prevailing economy provides an opportunity for unions if they are willing to work with and not against market forces. Unemployment is extremely low, especially in the unattractive jobs, such as sewing, meatpacking, and agriculture, to which immigrant workers tend to gravitate. What workers need right now, while their negotiating position is strong, is the ability to bargain honestly and above-board for better wages and working conditions. Government can only interfere in this process. □

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The Logic and Morality of Takeovers

by Norman Barry

Of all the features of the market, the takeover process is still the most reviled. Assailed by moralists for encouraging greed and antisocial individualism and for breaking up stable communities; by some economists for its alleged short-termism, irrational stock-market speculation, and the loading of companies with debt; and by politicians who, while anxious not to appear opposed to capitalism, are eager to make political capital out of any slightly disreputable feature. Look at Germany and Japan, they say. Those economies rarely use takeovers, and they are doing pretty well, though the use of the present tense in both substantive parts of that sentence might well be questioned. The language used to describe takeovers is emotive—those who bring about necessary corporate restructuring are called predators and raiders, as if they belonged either to the jungle or the criminal class.

But it is easy to show that they are doing something which is intrinsically part of the market economy's search for efficiency and that it is quite consistent with the high standards of the morality of the market, for example, ensuring that fiduciary duties to owners are fulfilled, something that is not a striking feature of the German or Japanese market systems. The takeover phenomenon has developed its own exotic language—poison pills, golden parachutes, greenmail, and junk bonds are good examples. All sound slightly sinister and are things that respectable capitalism apparently could do without.

Why Takeovers?

Takeovers arise out of something endemic to the market system—the agency problem. In a publicly quoted company, characterized by the separation between ownership and control, how can the dispersed stockholders protect themselves against opportunism from the management? Will the latter not be tempted to spend company assets on themselves, their personal ambitions (often dressed up as morality), and empire-building, rather than paying the highest feasible dividends to stockholders? Adam Smith was aware of the problem and had a well-known hostility to the joint stock company. He preferred owner-managed enterprises. Indeed, America in the 1960s and 1970s experienced a version of economically mistaken and morally reprehensible takeovers. Cash-rich companies did not return money to the stockholders but embarked on counterproductive takeovers—the creation of unwieldy conglomerates that contributed only to the well-being of the managements.[1] It was the legendary corporate raider T. Boone Pickens, who, in an Israel Kirzner-like manner, noticed that the oil companies were not extracting the full value of the reserves but instead were embarking on quite

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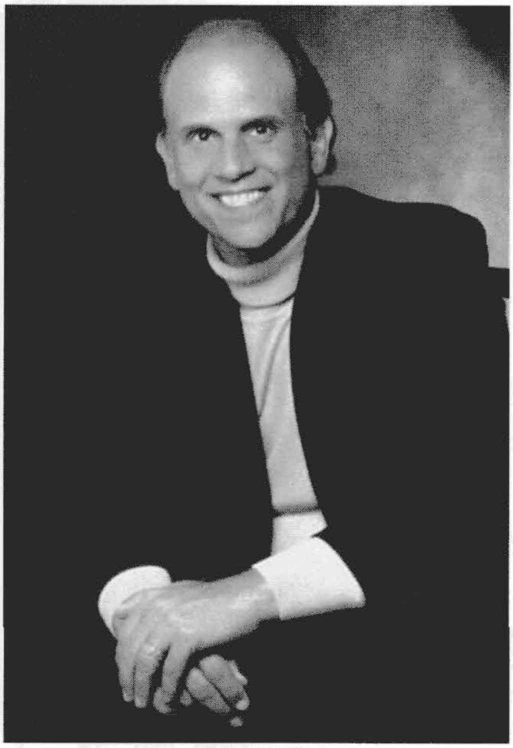

Michael Milken

unnecessary research, exploration, and expansionism. He therefore pioneered the economically productive strategy of taking them over and then breaking them up—spinning off unwanted parts and working the viable parts more efficiently. The fears of the left, that takeovers *always* lead to the swallowing up of small companies and the concentration of industry are groundless. The efficient ones do the reverse and lead to the survival of lean and economical companies.

The takeover process is part of a normal market system—it is the market for corporate control.[2] Those who succeed in this market have, in effect, secured the best use of managerial talent. Without all this, the modern company really would produce industrial "princes" over whom the dispersed stockholders would have no control. It might be that other economies, perhaps those that rely on trust rather contract, can induce good behavior in other ways, but as economies become more anonymous they have to resort to this method. It has never been without its critics. Surely, the immense costs involved through the payment of lawyers and financial intermediaries can be avoided? Will not the emphasis on the takeover method induce managers, through fear of losing their jobs, to concentrate more on the share price than on long-term research and development? What has mere paper shuffling got to do with running a successful company?

All these questions have been decisively answered by serious research. The takeover method does add value in terms of increased share prices, though it is true that the owners of target companies do significantly better than stockholders in the acquirer. The owners of the target have to be offered a premium to persuade them to part with their stock, but the movement of the share price for the significant period after the acquisition indicates that almost everybody gains. The fees earned by the various intermediaries are simply the price we pay for increased efficiency. Perhaps managements have an interest in provoking an unproductive takeover, but the market has its own solution to such opportunism—increased stockholder vigilance, although there is the problem of dispersed shareholders' having little or no incentive to act.

The claim that the process leads to paper shuffling at the sacrifice of long-term development is refuted by research showing that the price of stock tends to rise on the announcement of future research and development.[3] It might be that "firm specific human capital" (labor appropriate for only one enterprise) is vulnerable to the predator concerned only with extracting more or less immediate value, and this might lead to under-investment, but all sorts of contracts have been devised to protect such labor from the vicissitudes of economic fortune.

Efficient Markets Hypothesis

Underlying the rationale of the takeover process is the "efficient markets hypothesis": the claim that at any point the capital market reflects all the profitable opportunities available. But the hypothesis does not predict the future; it simply accurately records the past. Entrepreneurial opportunities cannot be predicted from it. Does anybody really suppose that anybody else, for example, government, can improve on the entrepreneurial market in spotting investment opportunities?

In an efficient market there is said to be a "random walk," meaning that any investor can choose any stock with an equal chance of being successful. The share price embodies all the information currently available. In these circumstances the only person who can beat the market is the insider trader. Yet insider trading is neither inefficient nor necessarily immoral. If the insider is not in breach of an employment contract, he is contributing to the efficient running of the market by speeding up the flow of information.

Undoubtedly, the current economic success of America is a function of the massive corporate reorganization that took place as a result of the 1980s takeover boom. Yet it has been subject to the most severe, almost hysterical, criticism, as well as some rather good Hollywood movies. At that time, corporate governance was heavily biased toward management: shareholders were difficult to organize; very large companies were virtually bidproof; and the loan process was controlled by established investment banks supported by very conservative credit-rating, agencies (Moody's and Standard and Poor's in New York) that would give triple-A evaluations only to established blue-chip corporations. Indeed, the majority of companies could not get their bonds an investment rating at all, such was the (needless) fear of default. Then along came Michael Milken, who financed some of the most controversial takeovers of the era by the use of the inaptly, and ineptly, named "junk bond." Milken's genius almost guaranteed him a jail sentence.[4]

His entrepreneurial flair was to notice that the default rate on non-investment–grade debt was in fact quite low and that by offering high interest rates to compensate for what was originally quite a low risk he could attract big funds for investment. His first ventures were in start-up companies that had no financial records at all (CNN, for example, was made possible by junk bonds), and it was only later that he began to finance hostile bids. He struck fear into corporate America by returning power to the stockholders, and his creative methods posed a serious threat to the banking establishment. To use the pretentious language of the philosophy of science: the conventional rating agencies were crude empiricists; they only went on *past* company records and had no gift for spotting future successful entrepreneurs. Milken was, in the terms used by Sir Karl Popper, the bold innovator who discovered new opportunities for the advancement of knowledge. But there is nothing unusual in all this. America's financial history is very much a story of how upstarts upset the conventions and threaten the power and wealth of the elite. Milken effected a revolution in banking equivalent to that achieved by J. P. Morgan earlier in the century and by the much-castigated robber barons in business itself. Indeed, Milken's critics found a surprising affection for the robber barons, who at least, they said, made things.

Like many innovators before him, Milken had to pay the price of success. He and the investment bank he led, Drexel Burnham Lambert, were subjected to relentless persecution by the Securities and Exchange Commission, the Justice Department, and hostile news media. The leading figure in the move against Wall Street (although Milken worked out of Los Angeles) was that icon of the Republican Party, Rudolph Giuliani, the U.S. Attorney who aspired to be mayor of New York City and obviously saw political advantage in bringing financiers to book.

The pursuit of Milken was an affront to the rule of law.[5] He originally faced a 98-count indictment (including insider trading charges), which the Justice Department knew would not stick. So the department managed to coerce Milken to plead guilty to a six-count rap that consisted of trivial offenses. Traders don't really know what is legal or illegal, and past legal decisions are no real guide. If they want you, they will get you. Milken's problem was his success: he made $550 million in 1987 (that is not technically illegal and he was only the third-highest earner that year). He was duly given an original sentence of ten years in prison, which was later significantly reduced once the judge, Kimba Wood, had acquired some elementary knowledge of finance.

What Goes on in Takeovers?

If there is any force to the charges of immorality, they relate to some of the practices that have developed in the conduct of takeovers. It is advisable to look at these briefly one by one, but most of them relate to the battle between stockholders and management. Analysis reveals that the guilty parties are not the raiders but company employees. They have every incentive to resist corporate restructuring—their jobs are at stake. They have initiated all sorts of arcane devices to put off predators.[6] The "poison pill" is a method for making hostile bids extremely costly. The managers get the rules of a publicly quoted company changed so that, for example, existing shareholders get enhanced voting rights and the privilege of selling stock at inflated prices. These are triggered in the event of a hostile bid and can make it prohibitive. They are used by managements to prevent a genuine sale of the company and then to favor a suitor more amenable to them. They are forbidden by the British Takeover Code, but were upheld by the Delaware courts (via a perverse interpretation of the business judgment rule) in the 1980s. (Incidentally, this made it possible for the merger of Time and Warner, even though Paramount had made a higher bid for Time's stock).

There could be a case for poison pills *if approved by the stockholders,* who might think that better long-term value can be secured by resisting a possible breakup. There is evidence that these poison pills are economically successful. But poison pills normally are devices to enable managements to evade their fiduciary duties to owners.

"Greenmail" occurs when a raider buys a portion of the stock and then refrains from the takeover only if he is bought out by an offer for the stock that is not available to other stockholders. The villains here are not the greenmailers; they are simply putting out a signal that the company is undervalued and is a target. It is managements that are responsible, for they load the company with debt to buy off the greenmailer so that their positions in the company are saved. If they were acting in the interests of stockholders, they would not pay the greenmailer, but simply wait to see what happens. Managements are also helped by "golden parachutes," favorable severance terms, should the deal go ahead (one recalls James Garner's extremely generous one in the movie *Barbarians at the Gate*).

There may be an economic rationale for golden parachutes. Existing managers occupy key positions in the company, and it may be commercially viable to buy them off. Indeed, many managers negotiate such deals before they take up their positions. Of course, it might be in the interests of managers to provoke a takeover so as to secure a parachute. But here, as in so many areas, it is up to vigilant stockholders to look out for opportunism. Institutional shareholders have the major responsibility here because they are less vulnerable to the free-rider problem that faces the small, private shareholder.

Takeovers Are Good for Us

Despite the desperate ululating of communitarians, the takeover process has not led to the collapse of caring societies and the triumph of greed. Corporate and individual giving has never been higher in America, and membership of voluntary groups is as great as it was when Tocqueville first noticed it. America is a highly mobile society, and her citizens have always been prepared to go where the jobs are. Communities are quite safe from the ravages of the market because they emerge from the conditions of the market itself: free choice under the rule of law.

Even the introverted Japanese and European economies are succumbing to the value-enhancing allure of the takeover. T. Boone Pickens made a famous and unsuccessful venture into Japan in the late 1980s. But last year the British firm Cable and Wireless took over the privatized Japanese telecommunications company against formidable local opposition,[7] and in Italy, Olivetti successfully pulled off a reverse takeover of the Italian telecommunications business. Even the hitherto power-hungry Agnelli family found the lure of shareholder value irresistible.

Germany has, until recently, been slow to adopt the new method of industrial reorganization. Indeed, the originally hostile bid that Krupp made for Thyssen was turned into a tame merger by a formidable array of stakeholders. But things are changing. Vodafone-Airtouch (a mainly British company) has just achieved the most audacious takeover bid of all time in its $160 billion-plus capture of Mannesmann. The combined value of the companies is approximately $342 billion (and they are still counting). This is way ahead of that for the Time-Warner and America Online merger. Again, the deal was nearly spoiled by stakeholders (which included German Chancellor Gerhard Schroeder, who in late-1970s language worried deeply about the threat to the "culture" of the company). A big factor in the titanic battle (the most exciting event in Anglo-German history since the World Cup soccer final in 1966, which England also won) was the move on the part of some shareholders to get a German court to enforce the fiduciary duties on Mannesmann's management.

But let us not get too complacent. The animus against takeovers persists. It was so great that by the late 1980s almost every American state had passed restrictive legislation, such as limitations on the loss of employment that could result from takeovers, to reduce corporate raiding. These laws were generally promoted by managements and others desirous of protection against competition. It would be a tragic irony if America were to adopt the anti-takeover measures that rival capitalist systems are just beginning to abandon. □

1. See Michael Jensen, "Takeovers: Their Causes and Consequences," *Journal of Economic Perspectives*, 1988 (2), pp. 21–48.
2. Henry Manne, "Mergers and the Market for Corporate Control," *Journal of Political Economy*, 1965 (75), pp. 110–18.
3. Jensen, pp. 26–27.
4. For an analysis of Milken's activities from an Austrian perspective, see Norman Barry, *Business Ethics* (London: Macmillan, 1998), pp. 141–45.
5. For a superb legal defense of Milken, see Daniel Fischel, *Payback* (New York: HarperBusiness, 1995).
6. See Martin Ricketts, *The Economics of Business Enterprise* (London: Harvester Wheatsheaf, 1994).
7. See Norman Barry, *Respectable Trade* (London: Adam Smith Institute, 2000).

IDEAS ON LIBERTY
JULY 2000

Chemical Straitjackets for Children

In February, a group of physicians writing in the *Journal of the American Medical Association* reported that the use of "psychotropic medications prescribed for preschoolers increased dramatically between 1991 and 1995." About twice as many children between the ages of 2 and 4 were given Ritalin, Prozac, and other so-called psychotropic drugs at the end of that period as at the beginning of it. In a front-page story, the *New York Times* cited experts calling the finding "very surprising." It is about as surprising as finding the proverbial fox feasting on chickens. In a paper published in January 1957—at the dawn of the "new psychiatric revolution"—I stated that psychiatric drugs are "chemical straitjackets," controlling, not curing, the denominated patients.

In my last column (May), I commented about the nineteenth-century epidemic of mental illness called "masturbatory insanity." In this column, I comment about our present-day epidemic of mental illness called "attention deficit hyperactivity disorder (ADHD)."

To grasp the enormity of the stupidity that informs these so-called diagnoses, we must be clear about the difference between a diagnosis and a disease.

Webster's dictionary defines diagnosis as "The art or act of identifying a disease from its signs and symptoms." According to *The Oxford English Dictionary* (OED), it is the "Determination of the nature of a diseased condition; . . . also, the opinion (formally stated) resulting from such investigation."

The concept of diagnosis is contingent on the concept of disease. Diagnosis is the *name of a disease*, just as, say, violet is the name of a flower. For example, the term "diabetes" names a type of abnormal glucose metabolism. The disease qua somatic pathology—literal disease—is the abnormal metabolism; the diagnosis, "diabetes," is its name. Somatic pathology is diagnosed by finding abnormalities (lesions) in bodies or body parts. Disease qua somatic pathology may be asymptomatic and changing the nosology (classification of disease) can change the name but not the reality of somatic pathology as disease. Unless we keep in mind that diseases are facts of nature, whereas diagnoses are artifacts constructed by human beings, we forfeit the possibility of understanding the uses and abuses of the term "diagnosis."

Manipulating things is difficult, sometimes impossible. Manipulating names is easy; we do it all the time. Violet may be the name of a flower, or a color, or a woman, or a street. Similarly, a disease-sounding term may be the name of a bodily malfunction, or the malfunction of a car, a computer, an economic system, or the behavior of an individual or group. We cannot distinguish between the literal and metaphorical uses of the term "disease" unless we identify its root meaning, agree that *it* is the literal meaning of the word, and treat all other uses of it as figures of speech. In conformity with traditional medical practice, I take the root meaning of dis-

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ease to be a *bodily lesion*, understood to include not only structural malfunctions but also deviations from normal physiology, such as elevated blood pressure or depressed red cell count. If we accept this definition, then the term "diagnosis," used *literally*, refers to and is the name of a disease, and used *metaphorically,* refers to and is the name of a non-disease.

By identifying diagnosis as an *opinion*, the *OED* recognizes that it refers to a judgment. Typically, the process of diagnosing disease begins with the patient himself: he has aches or pains, feels feverish or fatigued, and judges that he is ill. If he complains about his body, then—in a medical context—his complaint constitutes a *symptom,* a medical-sounding word that implies that the patient's experience is a manifestation of a disease. The point to keep in mind is that a symptom may or may not indicate the presence of a (real) disease. Whether a symptom is or is not a manifestation of disease depends on its confirmation or non-confirmation by objective data.

Diagnosing Disease: Cui Bono?

Unlike bodily illnesses, mental illnesses are diagnosed by finding unwanted behaviors in persons or by attributing such behaviors to them. Bodily illnesses—say, cancer or diabetes—are located in bodies; mental illnesses—say, kleptomania or schizophrenia—are located in social contexts. Robinson Crusoe could suffer from cancer, but not from kleptomania.

The diagnosis of a mental illness validates its own disease status. Disease qua psychopathology cannot be asymptomatic and changing the nosology can change disease into non-disease and vice versa (for example, homosexuality into civil right and smoking into substance abuse). Mental diseases are diagnoses, not diseases. Conversely, psychiatric diagnoses (however constructed) are, *by definition*, mental diseases (or "disorders," to use the mental health professionals' preferred weasel word).

To understand the tactical rather than descriptive *uses* of terms such as "ill" and "patient," we must—following Cicero (106–43 B.C.)—ask: *Cui bono?* Cicero explained the importance of posing this question, primarily to oneself, as follows: "When trying a case [the famous judge] L. Cassius never failed to inquire, 'Who gained by it?' Man's character is such that no man undertakes crimes without hope of gain."

Mutatis mutandis, no man asserts that he or someone else has an illness without hope of gain. The goods that a person gains from asserting such a claim range from securing medical help for himself to justifying controlling the Other by defining coercion as cure. Consider the evidence:

- The disease of masturbation affected mainly children; so does the disease of hyperactivity.
- The disease of masturbation pained parents, teachers, and other adults, not the denominated patients; the disease of hyperactivity pains and does not pain the same persons, respectively.
- The disease of masturbation was treated with physical restraints forcibly imposed on the bodies of children; the disease of hyperactivity is treated with chemical restraints forcibly introduced into the bodies of children.
- The disease of masturbation was the favorite diagnosis of doctors and parents dealing with troublesome children in the nineteenth century; attention deficit hyperactivity disorder is the favorite diagnosis of doctors and parents dealing with troublesome children today.

Belief in masturbatory insanity was, as I emphasized, not an innocent error. Neither is belief in ADHD. Each belief is a manifestation of the annoyance that many ordinary childhood activities cause adults, of the adults' efforts to control or eliminate such activities to allay their own discomfort, and of the medical profession's willingness to diagnose disturbing childhood behaviors, thus rationalizing and justifying the domestication of children by drugs defined as "medication."

Formerly, quacks had fake cures for real diseases; now, they claim to have real cures for fake diseases. □

IDEAS ON LIBERTY
JULY 2000

Whole Language: Emancipatory Pedagogy or Socialist Nonsense?

by Patrick Groff

The "whole language" method of reading instruction is a highly popular, yet experimentally discredited teaching innovation. The educational principle that governs it falsely states that students best learn to read in the same informal, natural manner they previously learned to speak as preschoolers. The WL doctrine also erroneously insists that children be empowered to add, omit, and substitute meanings and words in written material—as they individually see fit.

Critics of WL note its appeals to educators to abandon direct, intensive, systematic, early, and comprehensive (DISEC) instruction in a hierarchy of prearranged discrete reading skills. The WL movement protests that DISEC teaching of reading is inhumane; a violation of each child's unique, immutable "learning style"; stifling of teachers' creativity by disempowering them; not "progressive" enough; too technical and mechanical; and hostile to the culture of low-income families.

But WL is misunderstood if it is seen as just a method of reading instruction.

In 1991 education professor Kenneth Goodman, co-founder of the whole language (WL) literacy development movement, edited the *Whole Language Catalog*.[1] It includes chapters written by leading WL economic/political theorists, who sought to convince educators and other audiences of the validity of the political, social, economic, and cultural agenda of WL. The writers made clear that the WL "philosophy," as it is dubbed, views teaching students to read as a prime means to bring about definitive political, social, economic, and cultural changes—of a radically left-wing nature.

The Ultimate Aim of WL Teaching

The DISEC teaching of reading is objected to by the *Catalog* on ideological (political, social, economic, cultural) grounds. The book emphasizes that WL is more than a sweeping reconstruction of how to teach reading skills; it prepares students to challenge traditionally or historically venerated political and socioeconomic mores or precedents.

The politically active WL teacher uses reading instruction as a convenient vehicle to aid and abet the establishment of socialist goals, policies, values, and ideals. Through bona fide WL reading instruction, students learn how to rise up and challenge "the interests and values of the Anglo, white, middle and upper classes," Harry Giroux proclaims in the *Catalog*.[2] They are prepared to oppose, writes Michael W. Apple, "the political right of the United States" by being ready to use

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their collective powers to change the world so that democratic [read 'socialist'] power replaces corporate power."[3] Elimination of the present "economic, cultural, and social policies of business and industry" clearly is the ultimate aim of WL reading teaching.[4]

In WL terms, for students to be literate in the full and finest sense means they are eager to disrupt the political, socioeconomic, and cultural status quo by committing themselves to a socio-historical reconstruction of society.[5] Reading instruction by WL teachers arms students to engage in socioeconomic class warfare, whenever and wherever it is ordained, the *Catalog* explains. The WL teaching envisioned to that end is given a fetchingly revolutionary title: *Liberation/ Emancipatory Pedagogy.*

Update on WL's Supreme Purpose

The socio-political agenda of WL, as expressed in the *Catalog*, was updated in six articles in the summer 1997 edition of the educational journal *Reading and Writing Quarterly*. Here, seven education professors, all well-known enthusiastic defenders of WL, and a fourth-grade teacher of like persuasion, expanded on what they call "The Politics of Literacy."

The first argument posed for the need to transform students' literacy development into political action is that the United States is not "a just and democratic society."[6] Proof of this provocative allegation is the supposed fact that "high unemployment is becoming a permanent condition" in America. It is claimed that unemployed parents are provided only "$208 a month" to "feed a family." At the same time, the family is "paralyzed by all the variables of pesticides and other chemicals" found in its food. The writers find that the depressed "state of the American economy" has "dampened working class and poor students' interests" in learning to read.

Also, so much "discrimination" now abounds in the nation that "many Americans" give up hope of finding a job. It thus is deemed outlandish to propose that "individuals must stand on their own"; that is, be expected to show personal initiative and responsibility for their future lives. Even philanthropies "are losing any sense of social responsibility"[7] for ameliorating the above evils, the writers complain.

Therefore, DISEC literacy development programs are criticized as not having "the power to overcome the effects of poverty and discrimination," as they are described. As the writer puts it, the goal of reading instruction "should be to educate students for democracy as a means of challenging a status quo in which a relatively small number of people—privileged by their race, class, gender, language, and sexual orientation—control a disproportionate share of society's social and economic resources."[8] Only "critical literacy" programs suffice in this respect. These are ones that teach students "to work toward a more just and democratic [again, read 'socialist'] society." Through the WL version of reading instruction, students are trained to attack the economic "status quo." Whole language reading instruction acts as the means "to help create the conditions for a more just and democratic society,"[9] the author emphasizes. That WL instruction has not yet achieved this goal purportedly is the fault of inadequately dedicated teachers, and not the WL theory.

The second major argument in the articles for using WL for political purposes concerns the conventional definition of reading ability. The historical conceptualization of reading ability was students' capacity to comprehend precisely the meanings that authors intended to impart.

It is argued, to the contrary, that teaching reading "should be viewed as socializing children into a particular set of social and cultural practices in particular social settings."[10] Educators who object to the validity of this approach are summarily dismissed as "cultural dupes merely acting out extant literacy practices."

The fourth-grade teacher-author in the *Reading and Writing Quarterly* describes how certain "social and cultural practices" are developed through WL teaching.[11] Her students first were led to be "shocked and angered" by past scenes of apartheid in South

Africa. Then, through the selection of literature, a "connection between racism in South Africa" in the past and "racism and injustice in the United States" in the present was established.

The third prominent argument for employing WL teaching to convey political-economic ideology centers on an attack on standardized reading tests.[12] That assault on those tests is not surprising since they measure how well students comprehend precisely the meanings authors planned to convey and not how well they are "socialized into particular social practices" of a left-wing origin.

The *Quarterly* writers voice vigorous grievances against the tests: they are "scientific," statistically sophisticated, and based on "meritocratic principles," that is, "glorify" competitiveness. Proof that these tests "corrupt the concept of fairness" is that students who score low on them typically are from politically oppressed low-income minority families. These students do not possess "the knowledge required" to score high on the tests and do not have "knowledge of test-taking skills." Therefore, testing these students signifies a "systematic bias" against them of a "racist" nature. Since it is held that the tests pander to students who are "white, male, middleclass, and American," scores on them thus "may be more findings of cultural difference [among students] than anything else."[13]

From the advent of the WL movement in the 1970s, its members have charged that standardized reading tests deliberately project socioeconomically disadvantaged students onto "a trajectory of school-based failure." The *Quarterly* writers repeated the common WL outcry that such testing must be abandoned and replaced with "individualized assessment" by bona fide WL teachers. This changeover, if activated, doubtless would work to the advantage of WL's reputation. So far, all the published accounts of WL instruction involving teacher assessment of students' reading conclude that it is superior to DISEC teaching. On the other hand, an overwhelming preponderance of relevant experimental research findings conclude the opposite.

The writers' fourth main argument for the necessity of WL teaching that politically indoctrinates students is that DISEC instruction is expressly designed to "protect the privilege of the upper and upper-middle classes by encoding their values and intentions into school reading practices." This encoding is said to take place through schools' adoption of traditional reading instruction textbook series, called basal readers. These series of books are castigated as a dastardly "remote control" device operated by "the upper-middle and upper classes" to "neutralize other peoples' [the downtrodden masses'] literacies in their efforts to control their lives."[14] Lower-class and minority students, the writers claim, cannot satisfy the rigorous requirements imposed by the readers, for example, "completing daily assignments and periodical tests," because they do not reflect these students' peculiar cultural "intentions and values" and "ways of making sense of [written] text."[15]

According to the writers, the economic upper-classes induce frustration among students by "design." Through the imposed adoption of basal readers, the socioeconomic despots engage in "manufacturing reading failures among their [lower-class] children and hindering their prospects for the future" for jobs with decent wages. As a result, underclass students "doubt the value of who they are and what they do and could know."[16]

Reflections on the WL Agenda

The WL movement's contention that certain members of the public school establishment must be authorized to shape the economic, political, and cultural institutions of the nation has distinctive precedents. For example, at the height of its influence in the 1930s, the Progressive Education Association expressed the same ambitions.

However, in light of the abject failure of socialism in the intervening years, revival of claims to its effectiveness, as currently made by the WL movement, takes on a particular distressing tone of déjà vu. The uneasiness one experiences in this regard is intensified by the statistically inaccurate, intensely partisan, and pitifully self-indulgent manner in which the WL theorists construct their argument for reading instruction as emancipatory pedagogy.

The scientifically invalid nature of WL reading instruction has been known since its inception. None of its unique principles or novel practices is corroborated by relevant experimental research findings. Whole language thus defends itself with qualitative (nonnumerical, anecdotal, subjective/impressionistic) research findings. A circular form of verification is adopted. Published reports refer exclusively to one another for confirmation.

Complimentary accounts of WL thus are notorious for their practice of the propaganda tactic called "stacking the deck." Any form of evidence that appears to support WL is approvingly displayed. None of the larger bulk of experimental data that finds WL inferior is cited. Examination of the defenses of WL thus leaves one with an eerie sense of disbelief, similar to that experienced on reading documents of Stalin's regime.

The greatest danger of WL's vision of politically oriented reading instruction doubtless lies in its irony. The WL plan, to liberate proletarian students from under the heel of the diabolical business and industrial class, rests largely on a fiction. It depicts a nonexistent society created as a convenient scapegoat for economic problems of the lower class, which in actuality are self-imposed to a great extent. It impetuously plays the "race card" whenever that expedient serves its purposes. It blames the messenger for the message in its aspersions on standardized reading tests.

Thus while it professes to be the savior of abused racial minorities, the WL political-economic agenda paradoxically turns out to be their deceiver. It delivers no demonstrably effective pathways for them to become literate, join in the prosperity of the nation, and actively contribute to its improvement. Why educators loyal to WL appear blind to its weakness in these respects is one of the notable enigmas in the history of government schools. □

1. Kenneth S. Goodman, Lois Bridges Bird, and Yetta M. Goodman, eds., *The Whole Language Catalog* (Santa Rosa, Calif.: American School Publishers, 1991).

2. Harry Giroux, "Literacy, Cultural Diversity, and Public Life," in ibid., p. 417.

3. Michael W. Apple, "Teachers Politics, and Whole Language," in ibid., p. 416.

4. Stanley Aronowitz and Harry Giroux, "Education under Seige" (South Hadley, Mass.: Bergin and Garvey, 1985), p. 66.

5. Bess Altwerger and Barbara Flores, "The Politics of Whole Language," in Goodman et al.

6. Curt Dudley-Marley, "Introduction: The Politics of Literacy," *Reading and Writing Quarterly* 13 (1997), p. 201.

7. Ibid.

8. Ibid.

9. Ibid.

10. David Bloome and Laurie Katz, "Literacy as Social Practice and Classroom Chronotypes," in ibid., pp. 221–22.

11. Maria Sweeney, "No Easy Road to Freedom: Critical Literacy in a Fourth-Grade Classroom," in ibid., p. 280.

12. Sharon Murphy, "Literacy Assessment and the Politics of Identities," in ibid., p. 263–66.

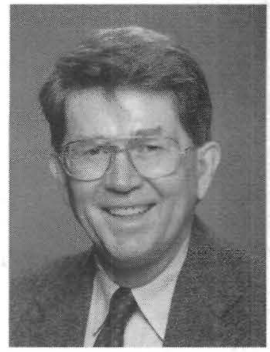
13. Ibid, p. 269.

14. Patrick Shannon and Patricia Crawford, "Manufacturing Descent: Basal Readers and the Creation of Reading Failures," in ibid., p. 228.

15. Ibid, p. 242.

16. Ibid, p. 234.

Economics



Running Out of Agricultural Land

Fear that we are running out of important resources is perpetual. Oil is a favorite thing to worry about; landfill space is another, and trees yet another. I could continue listing things (coal, copper, iron ore, even tin) that people have worried would soon be exhausted, and I plan to discuss the persistent fear of resource exhaustion in future columns. In most cases the fear is baseless—fueled by organized interests hoping to capture advantages by scaring the public, by sloppy journalism, and by a general lack of basic economic understanding. Where concern is appropriate, the problem is invariably the lack of private property rights in the threatened resource.

To see the role of property rights in preventing the depletion of resources, consider the following question: have we ever run out of a nonrenewable resource? I have asked dozens of audiences this question and have never found anyone who can name one. But aren't nonrenewable resources the ones we are most likely to run out of? After all, they are nonrenewable. More puzzling, we have run out of—driven to extinction—a number of animals, which are renewable. Aren't these the resources we should be least likely to run out of? The puzzle is resolved by recognizing that nonrenewable resources just sit there; they don't run around, so it is easy to establish private property rights over them. As I discussed in earlier columns, people conserve on resources they own by taking their future value into account. Many animals, because of their fugitive nature, are difficult to own as private property, and so people have little motivation to consider their future value. So despite their renewability, some of these animals have been extinguished.

Creating scares that we are running out of nonrenewable resources would be far more difficult if people understood the power of private property to motivate the proper consideration of our resources' future value. But in this column I consider another reason people mistakenly fear we are running out of, or dangerously depleting, resources—failure to distinguish marginal value from total value, a distinction I introduced last month.

Disappearing Farmland

I had just begun my first teaching job at the University of Colorado in 1972 when I was asked to participate in a debate on the "problem" of disappearing farmland. Despite my compelling arguments (several in attendance who agreed with me before the debate still agreed with me afterward) that decreasing farmland was the result of market forces working properly, concern over lost farmland has continued. For example, Lester Brown of Worldwatch Institute puts out an annual report predicting that food supplies will fall behind population growth, a problem he sees caused partly by the loss of farmland to development. In my local newspaper, columnist

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Tom Teepen recently warned, "Development is taking up farmland, forest and other open space in this decade at twice the rate of the 1980s. . . . Between 1992 and '97 some 16 million acres went to development."[1]

It is true that in the United States fewer acres are used for agriculture today than in the past, although the loss is far less than what Worldwatch and United States Department of Agriculture report.[2] But this "loss" of farmland is not a crisis or even a cause for concern. Instead, it is good news. First, with less land being used for farming, more land has reverted to open space and forest. You won't hear this from the crisis crowd, but there is more forestland in the United States now than 80 years ago.[3] Second, farmland has been paved over for shopping centers and highways, converted into suburban housing tracts, covered with amusement parks, developed into golf courses, and otherwise converted because consumers have communicated through market prices that development is more valuable than the food that could have been grown on the land.

Food or Golf

Why would consumers willingly sacrifice food for golf courses, shopping centers, and parking lots? Isn't food more valuable than golfing or parking? Of course—in total value. If the choice is between eating and no golf or playing golf but no eating, even the most avid golfer would choose eating. But economic choices are not all-or-none choices. Instead, we make decisions *at the margin*, deciding if a little more of one option is worth sacrificing a little bit of another. And at the margin it isn't clear that food is more valuable than golf or many other things we can live without. Golfers are communicating through greens fees that another golf course is at least as valuable as the additional food sacrificed.

At the margin, golf is certainly more valuable than food would be if millions of acres of farmland had not been "lost" to development. In 1900 most of the horsepower used on the farm was really horse power, or mule power, and tens of millions of acres were needed to grow the food for these animals. Trucks, tractors, harvesters, and other gasoline-powered farm machinery have efficiently substituted for these animals and the acres needed to feed them. Also, much less land is needed now to feed the same number of people because improvements in fertilizers, pesticides, irrigation, seeds, and weather forecasting allow more food to be grown per acre, and improvements in harvesting, packaging, storage, and transportation allow more of what is grown to get to the dinner table. If we still devoted as much land to farming as we did in 1900, with today's technology we would be knee-deep in cantaloupe. In this situation, how valuable would another few acres of cantaloupe be compared to another golf course that could be constructed on those acres?

We don't have nearly as much farmland as we did in 1900 because as food production increases, its marginal value decreases relative to that of houses, shopping centers, golf courses, and more. Consumers communicate this change in relative value with purchases that cause food prices to decline relative to the prices for other uses of farmland. This motivates a decrease in farmland that continues as long as the marginal value of land is greater in nonfarm uses than in agricultural production.

But don't expect the farmland "crisis" to disappear. Public agencies hoping for bigger budgets, and private organizations hoping for more research funding or larger subsidies, are always anxious to identify crises to scare the public. Crisis creation wouldn't be so easy if more people understood the difference between total value and marginal value. □

1. Tom Teepen, "Facts Justify Criticism of Suburban Sprawl," *Atlanta Journal and Constitution*, December 26, 1999, p. D4.

2. In chapter 2 of *Hoodwinking the Nation* (New Brunswick, N.J.: Transaction Publishers, 1999), the late Julian Simon gives examples of exaggerated claims by organizations, including the USDA, that benefit from the perception that farmland "loss" is a serious problem.

3. Gregg Easterbrook, *A Moment on the Earth* (New York: Viking, 1995), pp. 10–13.

IDEAS ON LIBERTY
JULY 2000

Gottfried Haberler: A Centenary Appreciation

by Richard M. Ebeling

During the first week of July in 1936, an international conference on the "Problems of Economic Change" was held in Annecy, France. It brought together such notable economists as Ludwig von Mises, Wilhelm Röpke, Oskar Morgenstern, Bertil Ohlin, Lionel Robbins, Dennis Robertson, Charles Rist, William Rappard, John B. Condliffe, John Van Sickle, Alvin Hansen, John Maurice Clark, and Jan Tinbergen.

They had come to this attractive French city south of Lake Geneva to discuss the problem of business cycles and their effect on the world economy. Little agreement was reached over the three days during which these leading economists met. But there was a single consensus among the attendees. One of the other participants at the conference, Gottfried Haberler, had set an example and standard for how research on the subject of business cycles should be undertaken. According to the official summary of the conference:

> There was throughout the whole conference one matter which secured the wholehearted support of all those present, namely the new technique in research which has been followed during the last two years in the study of the theory of the business cycle by Dr. Haberler. It will be recalled that he was appointed to a special post on the staff of the Economic and Financial Section of the League [of Nations]. . . . He was charged with the duty of examining the present state of knowledge in the theory of the business cycle and was to draw up a report on this subject. . . . [T]here can be no doubt that everyone present was greatly impressed by the very valuable results that had been achieved by the procedure followed in the case of Dr. Haberler's work. Indeed, "Haberler-like methods" became a catch-phrase of the entire conference.[1]

Haberler had spent two years carefully researching and consulting on the various competing theories of the causes and consequences of business cycles and formulated a "synthetic" alternative, the result of which was published in early 1937 under the title *Prosperity and Depression: A Theoretical Analysis of Cyclical Movements*.[2] For over 60 years it has been considered the classic summary and critical evaluation of the literature on this subject. Indeed, Joseph A. Schumpeter referred to it as a "masterly presentation of the modern material" for which he had the greatest "admiration."[3] And one of America's leading Keynesian economists, Paul A. Samuelson, hailed it as "the definitive study of business cycles, both pre- and post-Keynesian."[4] Austrian economist F. A. Hayek drew attention to Haberler's "excellent exposition" criticizing some of the fundamental assumptions and concepts of Keynesian economics.[5]

But this work was only one of Gottfried Haberler's many important contributions to

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economic theory and policy. In an economic career that spanned seven decades in the twentieth century, he made original contributions to monetary theory and policy, the theory of wages and union power, international trade theory, and the theory of economic development and growth.

Haberler was born on July 20, 1900, in Purkersdorf, near Vienna, Austria; the centenary of his birth offers the opportunity for an appreciation of his writings and his defense of the free market.

Early Studies

Haberler studied at the University of Vienna with three of the leading figures of the Austrian school of economics in the years immediately after the First World War: Friedrich von Wieser, Ludwig von Mises, and Hans Mayer. At the university his closest friends were three other students who, like himself, were to become internationally renowned economists in the decades to come: Hayek, Morgenstern, and Fritz Machlup. After Haberler earned his degrees in political science (1923) and law (1925), Mises helped arrange for him to receive a Spelman Fund (later Rockefeller Foundation) grant that enabled him to have two years of further study in the United States and Great Britain.

After returning to Austria, Haberler became a *privatdozent* (an unsalaried lecturer) at the University of Vienna, teaching a joint seminar with Hayek and Morgenstern. Mises arranged a paid position for him in the library at the Austrian Chamber of Commerce, where Mises was employed as a senior economic analyst. Haberler was a visiting professor of economics and statistics at Harvard University in 1931–1932. In 1934, he accepted the two-year appointment with the League of Nations in Geneva, Switzerland, that led to the publication of *Prosperity and Depression*. In the autumn of 1936, Haberler began a professorship in economics at Harvard University that lasted until his retirement in 1971. He also served as an economic consultant with the Board of Governors of the Federal Reserve System from 1943 to 1947. From 1971 until shortly before his death on May 6, 1995, at the age of 94, he was a senior scholar at the American Enterprise Institute in Washington, D.C.[6]

Many of Gottfried Haberler's writings in the 1920s and 1930s were devoted to problems in monetary and business cycle theory. Like other Austrian economists during this time, especially Mises and Hayek, Haberler focused his attention on price-level stabilization and monetary stability. In the 1920s the argument was made that a monetary policy that stabilized the general price level through changes in the money supply would assure economy-wide economic stability. In a series of articles and in his book *The Mean of Index Numbers: An Inquiry in the Concept of the Price Level and the Methods of Its Measurement* (1927), Haberler challenged the fundamental assumptions of a price-level stabilization policy.[7]

He argued that in fact there is no way to strictly measure and determine the general value of money through the use of index numbers of various types. The only precise definition of the value of money is that it is represented by the network of individual exchange ratios between money and all of the individual goods against which it trades. Every general index of prices is necessarily constructed by selecting some prices (various consumer or producer prices) as representative of the subgroup of goods under study. They are weighted according to their proportion of purchases, summed together, and mathematically averaged to create a statistical composite that is then tracked through time.

Thus every price index is "arbitrary," in that it depends on the types of goods or industries the economic analyst is interested in studying, the choice made concerning the weights to assign and the averaging method chosen to calculate their mean value, and the assumption that what is taken to be "constant" does not significantly change over the period during which the selected "price level" is being tracked.

Furthermore, Haberler argued, precisely because a price-level index is an average of the set of individual market prices from which it is constructed, it may hide all the significant individual relative price changes beneath its statistical surface. "The relative position and change of different groups of prices are not revealed, but are hidden and submerged in a general index," said Haberler. "Not the movement of the general price level, but the chronological succession of special price and price combinations . . . are regarded as significant for the waves of business life. . . . Such a general index rather conceals and submerges than reveals and explains those price movements that characterize and signify the movement of the [business] cycle."[8]

Also, Haberler maintained, a focus on an average price level tends to distract attention from the underlying microeconomic causes that result in a tendency for prices in general to move in one direction or another. And like his fellow Austrians, Haberler reasoned that a price-level "deflation" due to technological improvements and increased output resulting from lower costs of production is not a symptom suggesting a tendency toward a depression in the market economy. Instead, falling prices from those causes represent the market's method of bringing about an increase in people's real standard of living.

Austrian Business Cycle

Building on this reasoning, Haberler delivered one of the clearest expositions of the Austrian theory of the business cycle at a conference at the University of Chicago in 1932.[9] He explained that in the process of increasing the money supply sufficiently to prevent prices in general from declining owing to lower costs and greater output, a monetary expansion through the banking system pushes interest rates below the market level that would have been established by actual savings and investment demand in the economy. In the 1920s, this policy induced long-term investment projects in excess of real savings in the market, resulting in an imbalance that finally manifested itself in the economic downturn and depression that began in 1929 and intensified in the early 1930s.

During the 1930s Haberler took a view different from either Mises or Hayek about the solution to the Great Depression. His Austrian colleagues argued that the market had to be freed of government intervention, for supply and demand, and savings and investment to re-establish their own new equilibrium. Haberler reached a conclusion closer to that of Wilhelm Röpke, that once begun, the economic downturn of the early 1930s had increased to such an intensity that a "secondary depression" had set in, having little to do with any healthy correction from the malinvestments created by the Federal Reserve's monetary policy of the 1920s.[10] Rigid costs resistant to downward adjustment, bank panics and failures that caused an actual contraction in the supply of money and credit, and pessimistic expectations on the part of the investment community generated a situation in which only a government-initiated stimulus of spending and "effective demand" could bring about a reversal of the depressionary forces.[11]

While Haberler's anti-depression policy perspective might seem to have shifted him into a position similar to that advocated by John Maynard Keynes and the emerging Keynesian economics that came to dominate the economics profession beginning in the 1940s, that conclusion would only be partially correct. He did think that Keynes had made a number of valuable and influential contributions to economic understanding.[12] But in general, Haberler considered Keynes's "new economics" to be inferior to the traditional body of economic and monetary theory.

A cornerstone of Keynes's argument had been that even if market prices and money wages were flexible and adjusted downward during a depression, there was no guarantee that this would result in a return to economic balance and full employment. Haberler argued in the 1939 revised edition of *Prosperity and Depression*, as part of his critical evaluation of Keynes's *The General Theory of Employment, Interest and Money*, that Keynes had failed to appreciate what has become known as the "real cash balance effect."

Even if people were reluctant to spend in the depression because of pessimism and a desire to hold their wealth in a more liquid form, as prices and wages decreased, the real value and purchasing power of their money assets would be increasing, since each unit of money at lower prices could now buy more. A point would be reached at which people would find it advantageous to start spending again, at which time prices and wages would no longer have to fall and all those desiring employment would find employers willing to hire them to satisfy this renewed demand for goods and services. Haberler did not argue that an economic policy that fostered or permitted prices and money wages to fall during a severe depression until they found their own market level was necessarily the most desirous one. But he did insist that Keynes was wrong in stating that falling prices and wages could not restore equilibrium to the market.[13]

Inflation Opponent

Throughout the post-World War II era, Haberler was a vocal and forceful opponent of Keynesian-inspired inflationary policies to maintain full employment. He insisted that this was an economically dangerous path to follow, that it merely reinforced the very market rigidities that were causing any persistent and significant levels of unemployment in the economy. Neither private business practices nor powerful unions could bring about a permanent and continuing rise in prices in the market. If the money supply was not increased, prices or wages pushed above their market-clearing levels could only result in unsold inventories and unemployment. In the 1950s, 1960s, and 1970s, Haberler argued that any problem of prolonged and high unemployment was caused by anticompetitive trade union practices that priced a portion of the work force out of the market through money wage demands set above what market employers considered labor to be worth.[14]

Any prolonged price inflation had its origin in expansionary monetary policy. Government inflationary policies could temporarily reduce the unemployment generated by union wage demands only by creating enough money in the economy so that employers could afford to pay higher money wages. But this was only a short-run solution, since unions would then demand even higher money wages for their members to compensate for the lost purchasing power resulting from the higher prices caused by the monetary expansion. Equally counterproductive and harmful was the imposition of wage and price controls in 1971 by the Nixon administration, Haberler insisted. This not only failed to deal with the real source of the inflationary problem—the monetary policy of the Federal Reserve System—but it inevitably created more distortions and imbalances by preventing prices and wages from adjusting to changing conditions of supply and demand.[15]

In the late 1970s there developed the strange phenomenon of both rising prices and rising unemployment, a mix of inflation and unemployment that seemed to defy the standard Keynesian ideas of the time. Haberler explained that "stagflation," or an "inflationary recession," was a frustrating but easily understood combination of events. Unions and other special-interest groups had become so used to inflation that they now demanded money wage and price increases in expectation of future price inflation. When the actual increasing rate of price inflation turned out to be less than expected, greater unemployment resulted because money wages had been pushed above even what the expanding money supply was able to validate. And Haberler was doubtful that even the most "rational" of expectations could ever assure that such mismatches did not occur.[16]

In an analysis of what the best of economic policy worlds should be, Haberler said that the federal government should run a budget surplus and pay off the national debt so the funds could be rechanneled into productive, private-sector investment and capital formation; taxes should be significantly lowered to enhance work and investment incentives; monetary policy should be limited to a low, steady increase in the money supply equal to the annual average rise in real gross domestic product; and deregulation should be the order of the day, eliminating the various privileges, restrictions, protections, and subsidies that restrain or prevent an open, competitive market from more fully functioning. The same rules applied to the international economic order as well.[17]

Opportunity Cost and International Trade

Gottfried Haberler's other main contribution to economic theory and policy in the twentieth century was in the field of international trade and economic development. Beginning in the late nineteenth century, the Austrian economists, along with William Stanley Jevons and Leon Walras, had radically changed the foundations of economic theory by developing the theory of marginal utility in place of the labor theory of value championed by the classical economists from Adam Smith and David Ricardo to John Stuart Mill. But in the theory of international trade it was still common to demonstrate the benefits from the division of labor among nations on the basis of the labor theory of value. Comparing the relative costs in labor time for different countries to manufacture various goods showed the comparative advantage that different nations might have for specialization of production.

Haberler helped revolutionize the foundations of international trade theory by restating the theory of the international division of labor on the basis of the Austrian theory of opportunity cost. The relevant cost was not the labor time to produce something, but the alternative end that has to be forgone. Haberler demonstrated the logic of this principle by being the first to construct that simple diagram that is now found in every principles of economics textbook: the production possibilities frontier, which depicts the trade-offs that an economy faces between producing, say, one of two products. The members of that economy can produce either one of the goods or some combination of the two. The curve shows the additional amount of one good that can be obtained by forgoing a particular quantity of the other.

Haberler explained that even when one of two countries is absolutely more efficient in producing both goods, each country should still specialize in manufacturing and trading those commodities in which it has relatively greater efficiency. In developing and consistently applying this reformulated theory of the benefits of international specialization, he was able to prove the continuing superiority for a policy of free trade over protectionism or autarkic self-sufficiency.[18]

In the years following World War II, Haberler argued forcefully against various forms of international trade restriction and protectionism, including artificial foreign exchange-rate regulations and manipulation, import and export quotas, and tariffs. While admitting that a number of hypothetical exceptions to the free trade doctrine can be formulated, in the real world both the theoretical and practical case for the greatest degree of international freedom of trade remains the benchmark for any serious economic policy discussion.[19]

Finally, Haberler insisted that the underdeveloped countries of the "Third World" were moving in the wrong direction by turning to planning, controls, and protectionism in the name of economic development and growth. He reasoned forcefully that international trade would not create either permanent underindustrialized dependency on Western industrial nations or worsening terms of trade. Nor would government-induced domestic production either create real industrial efficiency or raise the standard of living of the people in those countries, in comparison to participation in the international division of labor. The best policy for all nations remains the freest exchange of goods and capital for economic improvement and rising living standards for the greatest number of participants in the global marketplace.[20]

As Gottfried Haberler once ended one of his essays, "The conclusion is obvious. The task of freeing the market economy from as many of its fetters as possible, and of promoting free competition, is of paramount importance."[21] His long, productive professional life was a testament to this goal. □

1. "The Proceedings of the Conference called by the Rockefeller Foundation to consider the Desirability and Feasibility of Encouraging Co-ordination of Fundamental Economic Research upon Problems of Economic Change," Annecy, France, July 3–5, 1936 (anonymous, mimeographed), p. 14.

2. Gottfried von Haberler, *Prosperity and Depression: A Theoretical Analysis of Cyclical Movements* (Geneva: League of Nations, 1937, revised and enlarged editions, 1939, 1941, 1958).

3. Joseph A. Schumpeter, *History of Economic Analysis* (Oxford: Oxford University Press, 1954), p. 1123.

4. Paul A. Samuelson, "Gottfried Haberler as Economic Sage and Trade Theory Innovator," *Wirtschaftspolitische Blätter,* No. 4 (1990), p. 310.

5. F. A. Hayek, *The Pure Theory of Capital* (London: Macmillan, 1941), p. 395.

6. See, "Between Mises and Keynes: An Interview with Gottfried von Haberler (1900–1995)," *Austrian Economics Newsletter*, Spring 2000; this previously unpublished interview was conducted in 1979 by Richard M. Ebeling and Joseph T. Salerno.

7. Gottfried Haberler, *Der Sinn der Indexzahlen. Ein Untersuchung über den Begriff des Presissniveaus und die Methoden seiner Müssung* (Munich: J. C. B. Mohr, 1927); "Critical Notes on Schumpeter's Theory of Money: The Doctrine of the 'Objective' Exchange Value of Money" [1925], in Anthony Y. C. Koo, ed., *Selected Essays by Gottfried Haberler* (Cambridge, Mass.: MIT Press, 1985), pp. 531–52; "A New Index Number and Its Meaning" [1928], in Anthony Y. C. Koo, ed., *The Liberal Economic Order, Vol. II: Money Cycles and Related Themes by Gottfried Haberler* (Brookfield, Vt.: Edward Elgar, 1993), pp. 107–17; and *The Different Meanings Attached to the Term 'Fluctuations in the Purchasing Power of Gold' and the Best Instrument or Instruments for Measuring Such Fluctuations* (Geneva: League of Nations, F/Gold/74, March 1931).

8. Haberler, "A New Index Number and Its Meaning," pp. 113–15.

9. Gottfried Haberler, "Money and the Business Cycle," in Quincy Wright, ed., *Gold and Monetary Stabilization* (Chicago: University of Chicago Press, 1932), pp. 43–74; reprinted in Koo, ed., *The Liberal International Economic Order*, Vol. II, pp. 160–74, and Richard M. Ebeling, ed., *The Austrian Theory of the Trade Cycle and Other Essays* (Auburn, Ala.: Ludwig von Mises Institute, 1996), pp. 37–64.

10. See, Richard M. Ebeling, "Wilhelm Röpke: A Centenary Appreciation," *The Freeman: Ideas on Liberty*, October 1999, pp. 19–24.

11. Haberler, *Prosperity and Depression* (1941 edition), pp. 323–44. For his mature evaluation of the Great Depression and policy choices during the 1930s, see "The World Economy, Money, and the Great Depression, 1919–1939" [1976] and "The Great Depression of the 1930s—Can It Happen Again?" [1980], in Koo, ed., *Selected Essays*, pp. 363–427.

12. Gottfried Haberler, "*The General Theory*: Five Views," in Seymour E. Harris, ed., *The New Economics: Keynes' Influence on Theory and Public Policy* (New York: Alfred A. Knopf, 1947), pp. 161–80; and "*The General Theory* After Ten Years" (1946) and, "Sixteen Years Later" (1962) in Robert Lekachman, ed., *Keynes' General Theory: Reports of Three Decades* (New York: St. Martin's Press, 1964), pp. 269–296.

13. Haberler, *Prosperity and Depression* (1941 edition), pp. 242–44; 403–04; 498–503; and "The Pigou Effect Once More" [1952], in Koo, ed., *Selected Essays*, pp. 573–80. The positive effect from falling prices and money wages on the real value of cash balances as a method for restoring full employment became known in the economics profession as the "Pigou Effect," after the Cambridge University economist Arthur C. Pigou, who developed the argument, but only several years after Haberler's formulation in 1939. See Arthur C. Pigou, "The Classical Stationary State," *Economic Journal*, December 1943, pp. 343–51, and "Economic Progress in a Stable Environment," *Economica* [1947], reprinted in Friedrich A. Lutz and Lloyd W. Mints, eds., *Readings in Monetary Theory* (New York: Blakiston, 1951), pp. 241–51.

14. Gottfried Haberler, "Wage Policy, Employment and Economic Stability," in David McCord Wright, ed., *The Impact of the Union* (New York: Harcourt, Brace, 1951), pp. 34–62; "Wage Policy and Inflation," in Philip D. Bradley, ed., *The Public Stake in Union Power* (Charlottesville, Va.: University of Virginia Press, 1959), pp. 63–85; and, "Wage-Push Inflation Once More," in Erich Streissler, Gottfried Haberler, Friedrich A. Lutz, and Fritz Machlup, eds., *Roads to Freedom: Essays in Honour of Friedrich A. von Hayek* (New York: Augustus M. Kelley, 1969), pp. 65–73.

15. Gottfried Haberler, *Inflation: Its Causes and Cures* (Washington, D.C.: American Enterprise Institute, 1961; revised and enlarged ed., 1966); *Incomes Policies and Inflation: An Analysis of Basic Principles* (Washington, D.C.: American Enterprise Institute, 1971); *Incomes Policy and Inflation: Some Further Reflections* (Washington, D.C.: American Enterprise Institute, 1972); "The Phenomenon of Worldwide Inflation," in David I. Meiselman and Arthur B. Laffer, eds., *The Phenomenon of Worldwide Inflation* (Washington, D.C.: American Enterprise Institute, 1975), pp. 13–25; *Some Currently Suggested Explanations and Cures for Inflation* (Washington, D.C.: American Enterprise Institute, 1976).

16. Gottfried Haberler, "The Problem of Stagflation," in William Fellner, ed., *Contemporary Economic Problems* (Washington, D.C.: American Enterprise Institute, 1976), reprinted in Koo, ed., *Selected Essays by Gottfried Haberler*, pp. 349–62; *Stagflation: An Analysis of its Causes and Cures* (Washington, D.C.: American Enterprise Institute, 1977); *The Problem of Stagflation: Reflections on the Microfoundations of Macroeconomic Theory and Policy* (Washington, D.C.: American Enterprise Institute, 1985); *Notes on Rational and Irrational Expectations* (Washington, D.C.: American Enterprise Institute, 1980); Koo, ed., *Selected Essays*, pp. 603–17.

17. Gottfried Haberler, *Economic Growth and Stability: An Analysis of Economic Change and Policies* (Los Angeles: Nash Publishing, 1974); *The Challenge to the Free Market Economy* (Washington, D.C.: American Enterprise Institute, 1976); and, "An Overview of Economic Policy: 'A Positive Program for a Benevolent and Enlightened Dictator,'" [1985] in Richard J. Sweeney, Edward Tower, and Thomas D. Willett, eds., *Judging Economic Policy: Selected Writings of Gottfried Haberler* (Boulder, Colo.: Westview Press, 1997), pp. 21–43.

18. Gottfried Haberler, "The Theory of Comparative Costs and Its Use in the Defense of Free Trade" [1930], in Koo, ed., *Selected Essays*, pp. 3–19; *The Theory of International Trade, with Its Applications to Commercial Policy* (London: William Hodge, 1936 [1933]); *A Survey of International Trade Theory* (Princeton: Princeton University Press, 1961).

19. Gottfried Haberler, "The International Economic Order in Historical Perspective" [1979], in Anthony Y. C. Koo, ed., *The Liberal Economic Order*, Vol. I, *Essays, on International Economics by Gottfried Haberler* (Brookfield, Vt.: Edward Elgar, 1993), pp. 349–70, and several other essays in this volume.

20. Gottfried Haberler, "International Trade and Economic Development" [1959], "Terms of Trade and Economic Development" [1961], and "Integration and Growth of the World Economy in Historical Perspective" [1964], in Koo, ed., *Selected Essays*, pp. 453–527; "Liberal and Illiberal Development Policy" [1987] and "Liberal and Illiberal Trade Policy: The Messy World of the Second Best" [1988], in Koo, ed., *The Liberal Economic Order*, Vol. I, pp. 371–413; and "Trade and Development Policy," in Sweeney, et al., *Judging Economic Policy*, pp. 173–227.

21. Haberler, *The Challenge to the Free Market Economy*, p. 18.

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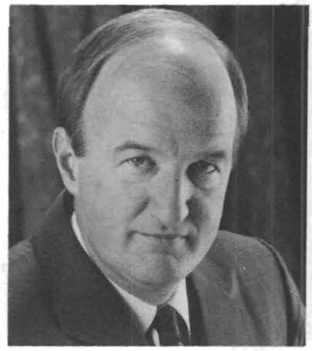

Neither Left nor Right

"Those who control the adjectives win."
—LARRY ABRAHAM

The use of the political labels "left" and "right" may be popular in today's media, but there are several reasons why the dichotomy is a false and misleading guide to political and economic philosophy. It implies that "left" is equally as extreme as "right," while the "middle of the road" position appears the more moderate and balanced position.

I call this system the pendulum approach, where each individual is categorized along a political spectrum from "extreme left" to "extreme right." Recently I encountered an example in an economics textbook.

Radical	Liberal	Conservative
Extreme Left		Extreme Right
MARX	KEYNES	ADAM SMITH

Source: Mark Maier and Steve White, *The First Chapter*, 3rd ed. (New York: McGraw-Hill, 1998), p. 42.

The problem with the pendulum approach is that Adam Smith is characterized as "extreme" as Karl Marx. By implication, neither economist is sensible. Yet the evidence is overwhelming that Adam Smith's system of natural liberty has advanced civilization far more than Karl Marx's inexorable system of alienation and exploitation.

Moreover, in the pendulum approach, the middle-of-the-road position held by John Maynard Keynes appears to be the moderate ideal. A pendulum that experiences friction will eventually come to rest in the middle, between both extremes. But is that the best way to go?

A New Alternative: The Totem-Pole Approach

I prefer a fresh approach, which I call the top-down or "totem pole" way. Instead of left to right, I use top to bottom. In Indian folklore, the most-favored chiefs are placed at the top of the totem pole, followed by less important chiefs below. Look at the next page for my rendition of the same three economists according to the totem-pole method.

In this system, I rank Adam Smith first, Keynes second, and Marx third. Of the three, Adam Smith advocated the highest degree of economic freedom. Nations that have adopted Smith's vision of laissez-faire capitalism have fared the best. Next is Keynes. He usually favored maximum freedom in the microeconomic sphere, but frequently endorsed heavy intervention (inflation and deficit spending) in the macro sphere. His big-government formu-

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la has resulted in slower economic growth in many industrial nations. The low man on the totem pole is Marx, who advocated a command economy at both the micro and macro level. Historically, centrally planned Marxist nations have vastly underperformed the market economies.

Political and economic positions should not be divided by left and right. They are either right or wrong. As Milton Friedman has said many times, "There's only good economics and bad economics."

Avoid Being Close-Minded

A second reason why I avoid the left-right labels is that it puts people and ideas into boxes. When someone's theories are labeled and compartmentalized, thinking stops and name-calling begins. There has been far too much bad blood spilt over the years between camps that spend more time shouting epithets than engaging in legitimate dialogue.

This criticism applies equally to the worn-out adjectives "liberal" and "conservative." If John Kenneth Galbraith is a "liberal," why should conservatives listen to him? If Milton Friedman is a "conservative," why should liberals read his books? I try not to prejudice myself. To me, both are economists who have ideas worth examining.

The media will continue to use the hackneyed political lexicon of yesteryear and engage in character assassination. But I will resist the outdated and misleading left-wing/right-wing/liberal-conservative battle lines, and treat every scholar, candidate, and philosopher on his own merits, and not according to some arbitrary label. □

BOOKS

The Quest for Cosmic Justice
by Thomas Sowell
The Free Press • 1999 • 214 pages + ix • $25.00

Reviewed by Donald J. Boudreaux

The Quest for Cosmic Justice offers no big surprises to anyone familiar with Sowell's work. Its theme of arrogant elites' tyrannizing ordinary folk has sounded prominently in Sowell's writings since at least the late 1970s. But the book percolates throughout with ingenious smaller-scale insights that make it well worth reading.

By "cosmic justice" Sowell means the relief of all misfortune. It is the broadest concept of justice going. The narrowest (and, in Sowell's view, correct) concept of justice is the traditional one—justice defined according to the fairness of the process. If the process is unbiased and if all parties abide by the agreed-on rules, then justice prevails. Of course, traditional justice does not require that fair processes exhibit a 100 percent error-free record. Even the fairest and most scrupulous criminal-justice system, for example, will sometimes mistakenly convict innocent people and sometimes mistakenly acquit guilty ones.

Nor does traditional justice require, even when no error mars the process, that the result is one that would satisfy a benevolent omniscient designer. The fact that something in my background beyond my personal control—poor musical genes, absence of childhood piano lessons, whatever—prevented me from becoming the concert pianist that I would ideally like to be is not an injustice.

The understandable human emotion to help the less fortunate has led to a confusion of language in which "injustice" is becoming synonymous with misfortune. (Calling something an "injustice"—unlike calling something a "misfortune"—suggests that remedial action is appropriate.) This confusion would be merely annoying if it did not breed support for public policies that exacerbate rather than ameliorate problems. Pinpointing and explaining these unfortunate consequences of public policies is among Sowell's chief talents.

For example, Sowell recognizes that it is regrettable that a person charged with murder suffered child abuse—child abuse that might plausibly be responsible for the murderer's disregard for human life. But the quest for cosmic justice that prompts the court to temper its punishment of the accused because of his unfortunate past ends up unleashing even more torment and suffering. A murderer is eventually let loose who will too likely kill again. In its quest for cosmic justice the court puts innocent people at much greater risk of being denied traditional justice.

Sowell's explanation of why traditional justice is better than cosmic justice is second to none. The reason is suggested by the title of the book—the *quest* for cosmic justice. People can and do venture on this quest, but it is futile. Attempts to correct today for all of the injustices as well as misfortunes of the past presume, first, that we have sufficient knowledge to succeed in this quest and, second, that those flesh-and-blood individuals who are to carry out this quest can be trusted with the enormous power necessary for such a celestial and open-ended endeavor. As Sowell explains, each presumption is wildly mistaken.

Running throughout all of Sowell's work is his appropriate disdain for elites. For many years I had pasted to my office door the final line of Sowell's magnificent *Knowledge and Decisions*: "Freedom is . . . the right of ordinary people to find elbow room for themselves and a refuge from the rampaging presumptions of their 'betters.'" Sowell hammers home the truth that when the state tries to do anything other than ensure traditional justice it necessarily bestows unequal and frightful powers on a select few to decide the fate of the many.

But as discerning as Sowell is, *The Quest for Cosmic Justice* is not a flawless book. Sowell goes astray when he compares legislatures to courts. He shares with Robert Bork and other late-twentieth-century conservatives a burning abhorrence of judges who "make law"—an abhorrence, no doubt, that springs from the judicial engineering unleashed on Americans by the Warren and Burger Courts.

It is proper to lament legislating from the bench, but Sowell is too trusting of legislation made by legislatures. The real problem is legislation, not the identity of the legislature. Or, put differently, the problem with judicial activism is not that it is social engineering by judges; the problem is that it is social engineering. Any attempt at social engineering is fraught with dangers, and anyone given the power to practice such engineering necessarily enjoys too much power over the objects (namely, ordinary people) of his engineering schemes.

Despite this flaw (and a few other ones too tiny to mention), *The Quest for Cosmic Justice* is vintage Sowell: brilliant, sparkling, and germane. □

Donald Boudreaux is president of FEE.

Judgments on History and Historians

by Jacob Burckhardt,
translated by Harry Zohn

Liberty Fund • 1999 • 290 + xxvii pages • $17.00 cloth; $9.00 paperback

Reviewed by William D. Curl

Historians and laymen alike will find immediate topical value in this compilation of notes and manuscript fragments from lectures presented by Jacob Burckhardt at Basel University, 1865–1885. A severe critic of his own time and staunchly countercultural by today's prevailing ideologies, Burckhardt differentiated himself in two major areas: his approach to history, which considered every major era of man's development as having equal significance, and his nearly prescient belief in the dire consequences of the idealization and increasing powers of the state.

Burckhardt's perspective of history deviates greatly from most historians in that he argued against viewing mankind's existence as a progressive continuum contributing to modernity. Rather, he perceived each epoch as being significant because of its unique set of intrinsic values, intellectual and/or artistic achievements, cultural ethos, and spiritual insights, which contribute to the aggregate of humankind.

Judgments on History and Historians is divided into five sections: antiquity; the Middle Ages; the period from 1450 to 1598; the seventeenth and eighteenth centuries; and perhaps most significantly, the Age of Revolution. Burckhardt viewed the study of history in general and the ancient world in particular as having great value. Antiquity's specific significance was its bequeathal of our concept of the state and its creations in form and writing. It was also the birthplace of our religions. He maintained that "the contemplation of historical ages is one of the noblest undertakings. It is the story of the life and suffering of mankind viewed as a whole." He also felt that "Barbarians and modern American men of culture live without consciousness of history." The study of history was not a trivial pastime but a source of identity: "we feel ourselves the true descendants of the latter [peoples of antiquity] because their soul has passed over into us; their work, their mission, and their destiny live on in us."

If antiquity was the birth of mankind, the Middle Ages was its youth. "Whatever to us is worth living for has its roots there." This section is divided into 20 divergent topics ranging from "Christianity as a Martyr Religion" to "Islam and Its Effects" and the "Iconoclastic Controversy." These topics are not always treated with sympathy but always with insight. Typical of this is Burckhardt's evaluation of Islam's spiritual father: "Through the sensuous delineation of a future life, Mohammed gives his own measure."

Throughout this compilation Burckhardt refers to man's spirit and emphasizes freedom of the self. In Renan's *Marcus Aurelius*, Burckhardt finds "The highest goal of mankind is the liberty of the individual." And, "A man must belong only to himself." These are the basic ideas that become "the new faith of mankind."

It is in the final section on the Age of Revolution that Burckhardt is perhaps most interesting and accessible. In addition to the separation of church and state, the theoretical conviction of the harmfulness of any state interference, and other consequences, he specifies equality before the law as one of the enduring results of the revolution. Burckhardt cogently perceives these reformations as part of a broader, subtler shift in our concept of the state. He rightly dismisses Hegel's concept of the state as the realization of morality on earth, but concentrates on the more central issue of "the new concept of the extent of the state's power."

Judgments on History and Historians complements Burckhardt's work on historiography, published originally as *Force and Freedom*, reprinted by this same publisher as *Reflections on History*. Unlike later historicists and empirical economists who attempted to gain stature for their disciplines by mimicking the methods of the natural sciences, Burckhardt avoided the mistake of applying scientific methodology to history: "Of all scholarly disciplines history is the most unscientific, because it possesses or can possess least of all an assured, approved method of selection; that is, critical research has a very definite method, but the presentation of it has not. *It is on every occasion the record of what one age finds worthy of note in another*." He elaborated: "Every historian will have a special selection, a different criterion for what is worth communicating, according to his nationality, subjectivity, training, and period." The original title of *Force and Freedom* revealed not only his position in regard to historical research, but also placed him within the tradition of European Liberalism. Once called "the most civilized historian," Burckhardt was a scholar of remarkable erudition whose perspective of history and its significance to mankind is even more meaningful today than during his lifetime. □

William D. Curl is an adjunct scholar of the Ludwig von Mises Institute.

Real Federalism: Why It Matters, How It Could Happen

by Michael S. Greve

American Enterprise Institute • 1999 • 201 pages • $34.95 cloth; $16.95 paperback

Reviewed by George C. Leef

"Federalism's history has been the history of its demise." So writes Michael S. Greve in a book designed nevertheless to prove that, like Mark Twain's demise, the death of federalism has been greatly exaggerated. Federalism has been down for decades, floored by the pro-New Deal shift of the Supreme Court in 1937 and kicked repeatedly by the Court and Congress ever since. Greve, however, has found that it still has a pulse and shows some signs of getting up off the mat. Those of us who prefer freedom to government *diktats* should be encouraged because although federalism does not ensure freedom, freedom fares better under federalism than under a completely centralized politics.

Greve, executive director of the Center for Individual Rights, sets out first of all to explain the case for federalism, a case few Americans are familiar with. Federalism, he explains, is a means of injecting market competition into politics. "The citizens' ability to vote with their feet and take their talents and assets elsewhere will discipline government in the same way in which consumer choice, in nonmonopolistic markets, disciplines producers," Greve writes. As long as people have the right to leave political jurisdictions they find undesirable, states (or smaller government units) have to bear the costs of their mistakes. Organized labor, for example, might want a state to enact compulsory unionism, legislation against plant closings, and a $20 minimum wage, but the state that does so will soon find its economy withering.

The Constitution's drafters understood the need to maintain such discipline on the states and sought to secure it by creating a central government of strictly enumerated powers. With but a few exceptions, political controversies were not to be decided in Washington, where losers have the choice of living with it or departing the country. Instead, they would be settled at the state or local level—often without government at all.

But just as Jefferson observed that it is the natural order of things for liberty to give way to authority, it also seems to be the natural order of things for federalism to give way to centralization. Those who want to employ coercion would rather fight and win once at the national (or, as is becoming increasingly possible, international) level than fight dozens or hundreds of battles in smaller units where success is less likely and if achieved, less durable. Therefore, they devised a number of arguments to attack federalism, the most successful of which has been the "race to the bottom" argument ("without central control, competition will lead to unacceptably low standards"), which the Supreme Court has latched onto in some cases.

Opponents also have played the typical statist games with language, seeking to redefine federalism so it means what they want it to mean. Greve points out that for decades the Court hid its indifference to congressional aggrandizement by claiming that federalism really means the political process in which the boundaries between federal and state authority are hammered out—"process federalism." So the Court did not have to do anything but make sure that elections weren't canceled.

Greve attacks "process federalism" and other phony concepts and forcefully argues that real federalism—hence the title—means that Congress must be kept within the limits of the enumerated powers of the Constitution. But after decades of abject deference to Congress and the executive branch, is there any prospect of the Supreme Court's moving back toward real federalism?

The last decade has seen several decisions in which the Court did revive the long-dormant idea of federalism. Greve devotes much of the book to an analysis of those decisions, some of which do little more than hint at an inclination not to let Congress enact any piece of legislation it feels like, and some of which seem to presage a revitalization of real, that is, enumerated-powers, federalism. Will the Court continue to move in that direction?

Greve does not predict what will happen in the judicial realm, but seeks to explain how events could unfold to make it possible for a differently constituted Court to bring back the pre-New Deal federalism. The Court, for all its ostensible independence, does keep an eye on the political scene and is leery of making decisions that may kindle political firestorms. The Court, Greve avers, needs to feel that it has political cover before it can return to real federalism. That cover, he believes, can come from a coalition of "Leave-Us-Alone" types who differ greatly as to what they want to be left alone to do, but hold a common hatred of central Big Brotherism.

An intriguing and optimistic book. ☐

George Leef is the director of the Pope Center for Higher Education Policy at the John Locke Foundation and book review editor of Ideas on Liberty.

What Do Economists Contribute?

edited by Daniel B. Klein

New York University Press • 1999 • 156 pages • $50.00 cloth; $17.50 paperback

Reviewed by Philip R. Murray

Professor Daniel Klein of Santa Clara University is one of the most engaging and creative economists around. In *What Do Economists Contribute?* he and nine other economists (most of them known to readers of *Ideas on Liberty*) try to explain just how economists contribute to the betterment of mankind. Although the title implies that the book is directed to students and intelligent laymen who would otherwise not know the answer, the book is aimed just as much at professional economists themselves. All three groups, especially undergraduates contemplating graduate study in economics, will be fascinated and perhaps troubled by what they read.

Klein asks: "Are economists today, in making their individual choices, led to promote ends of human betterment?" He begins by playing the devil's advocate and gives several reasons why the contributions of economists might not lead to human betterment. Economists can be and often have been flat out wrong. Those who denigrated saving, for example, contributed to a lower standard of living today. Even when the advice of economists is good, the public will not necessarily take it. Economists who warned against wage and price controls in the 1970s could not convince the public to shun them. Sound economic principles, moreover, may be misapplied. Observe how free trade has mutated into "managed trade."

The problem is not that economists lack clout, but that some seek to maximize their influence by stooping to promote special interests. The late F. A. Hayek, in the essay reprinted here, urges economists not to "directly aim at immediate success and public influence." Seek "light," he recommends, not "fruits." In this way the economist maintains intellectual integrity and lessens the likelihood that economic insights will be misapplied.

If what economists have to contribute is so good, why don't more people tune in? Israel Kirzner grapples with George Stigler's claim that economic advice is not valuable. Stigler rejects the notion that societies would adopt bad policies without heeding the advice of economists and uses economic principles to support his claim. Kirzner responds: "it is just not the case that economics teaches the worthlessness of economic policy advice." The problem with Stigler's view, according to Kirzner, is that it fails to recognize error and its correction. People, including economists, make errors, and economists make valuable contributions when they correct them.

Clarence Philbrook responds to criticism that what some economists contribute is unrealistic thinking. He constructs the "probability approach" that he supposes would be employed by the scholar who would offer "realistic" advice. The gist of the approach is to rank proposals according to their probabilities of effecting change. His counterargument shows that this approach suffers from the impossibility of calculating the necessary probabilities and misses the main point that the quality of an idea is what matters most, not whether or not it is currently "realistic."

Several authors offer their criticism of the way some economists make their contributions, namely what Klein calls "paradigmaticism": overemphasis on "formal model-building" and "empirical work according to favored quantitative methods." The attempt to mathematicize economics has a heavy cost that Ronald Coase points out: "Aspects of the economic system which are difficult to measure tend to be neglected." This explains the lack of attention to property rights and entrepreneurship in economic textbooks. The late W. H. Hutt's paper predicts that the economist who builds models "may then find himself the possessor of a logical system which no legislator or administrator could be expected to understand, let alone find of service in the case of any concrete problem." In other words, the findings of the analytical economist do not necessarily spill over to benefit society.

Klein concludes that "paradigmaticism inhibits the cultivation of economic judgment in the professional economist." As evidence for Klein's point, consider the economic judgment of economists who were persuaded by statistical research in selected industries that increasing the minimum wage has no adverse effect on employment.

Since some economists certainly make no positive contribution, how do the authors recommend doing economics in a way that does advance human betterment? Gordon Tullock maintains that the economist can benefit society and achieve career success by doing research that exposes inefficient government policies and educating the voters through media and public speaking.

A deep understanding of economics necessarily gives one, to use Thomas Sowell's phrase, a "constrained vision," or an understanding that we cannot have everything. Contributing that piece of information in a political environment in which politicians routinely promise to do everything is sure to make one unpopular. Hayek concurred, saying that "above anything [the economist] must have the courage to be unpopular." □

Philip Murray is a professor of economics at Webber College in Babson Park, Florida.

Ask the Children: What America's Children Really Think About Working Parents

by Ellen Galinsky

William Morrow & Company • 1999 • 358 pages • $25.00

Reviewed by Darcy Ann Olsen

Let me be first to admit that a review of *Ask the Children* seems out of place in the pages of *Ideas on Liberty*. Ellen Galinsky travels outside libertarian circles. She has filled her book with cheerful anecdotes, not policy prescriptions. And she has found audience with viewers of the *Today Show*, not the *Lehrer News Hour*. But the book's central finding deserves illumination: there are as many ways to raise a happy child as there are children in the world.

What immediately distinguishes this book from hundreds of others on parenting, work, and family is Galinsky's unconventional research method. She conducted the first comprehensive study ever that asked parents and children for their views on work and home life. She did what few researchers and policymakers dare to do: she gave up the "expert" pulpit to let families and children speak for themselves.

More than 1,000 children aged 8 to 18 graded their parents A, B, C, D, or F on a range of parenting skills. Questions took the form "What grade would you give your mother on . . .," followed by 12 items including, "Making me feel important and loved" and "Encouraging me to want to learn and enjoy learning?" The questions were designed to assess a range of parenting skills that are strongly linked to children's social and emotional development and success in school. Galinsky examined the children's responses to see which characteristics of their parents' lives were most predictive of how they viewed their parents' skills. For instance, an analysis of the children's responses showed that having a working mother was never predictive of how children assess their mother's parenting skills. On the other hand, the study showed that the amount of time moms and dads spend with their children matters a great deal.

Reviews of *Ask the Children* have inspired headlines such as, "Vindication for moms of all vocations" and "New book may relieve working mothers' guilt." (That the book was marketed partly to moms who feel guilty about working outside the home is clear from the jacket cover. As one observer put it, "At last! It is time to end the endless debate, accept as children do that working parents are here to stay, and get on with improving the lives of these families and their children.")

Many people will be tempted to see this book as settling the debate over whether mothers' working is "good or bad" for children. Yet Galinsky cautions against that: "If the findings in this book are simply read and reported as another study that weighs in on whether mothers should or shouldn't work, that would be a terrible misreading. This study, like many others, shows that the impact of parental employment on children *depends* on a number of factors, including whether the parent is doing what he or she thinks is right." (Italics in the original.)

Drawing from her study and existing academic research, Galinsky concludes that the national debate about working and children is not an either-or proposition "as if one path is inherently good and the other bad." Children's outcomes depend on what parents do with their children when families spend time together and also on children's experiences when their parents are absent. As she puts it, "What works for one person doesn't work for another."

Of particular interest is Galinsky's discussion of the importance of "intentional parenting" and "parenting autonomy." In short, she finds that better child outcomes are strongly related to the desire to parent and to the ability to raise children in ways parents think right. Parents who raise their children the way they want to are less likely to have children who are unhappy, have trouble getting along with other children, are unable to concentrate, or are nervous and high-strung. That is, parental freedom is good for children.

The list of factors that influence a child's outcome is endless. A child's age, gender, and temperament only begin the list. Next overlay family structure, family finances, and parenting skills. Then add peer influence and education systems. All those things matter, and they matter differently to different children. What works for one child doesn't necessarily work for another. What seems certain is that child outcomes depend on many factors, not the least of which is parents' freedom to make their own choices, a finding that begs simultaneously for more intentional parenting and planning and less state interference in the child-care arena. □

Darcy Ann Olsen is director of education and child policy at the Cato Institute.

The Greedy Hand: How Taxes Drive Americans Crazy and What to Do About It

by Amity Shlaes

Random House • 1999 • 234 pages + bibliography and index • $22.95 cloth; $14.00 paperback

Reviewed by Sheldon Richman

The word "greedy" is so hopelessly vague that it is virtually useless. But if anyone can be said to be greedy, it's those who run the government. For them the word is appropriate both for how much money they want and how they get it: taxation, confiscation, fiscal force. Aside from a few freelance criminals, if the rest of us want more money, we go out and earn it. When the state wants money, it takes it, under color of law.

Amity Shlaes, a member of the *Wall Street Journal* editorial board, has written an enlightening book about the thousand cuts—big and small—inflicted on each of us by the U.S. tax system. Alas, some of us are so inured that we don't notice them—which may explain why taxes aren't the hot issue they ought to be. How many people know that the government's aggregate take is at an all-peacetime high?

Shlaes's title comes from the introduction to the second part of Thomas Paine's great book, *Rights of Man*. Paine noted, "If, from the more wretched parts of the old world, we look at those which are in an advanced stage of improvement, we still find the greedy hand of government thrusting itself into every corner and crevice of industry, and grasping the spoil of the multitude. Invention is continually exercised, to furnish new pretenses for revenues and taxation. It watches prosperity as its prey and permits none to escape without tribute." Little that has been written since is as perceptive.

Shlaes ranges far in her survey of the tax landscape. She covers the income tax, including the clever withholding system and the cost of compliance; Social Security and Medicare payroll taxes; the death tax; sales taxes; and the marriage penalty. She details the daunting harassment of taxpayers who work for themselves or who hire nannies for their children. She shows the ways the state tries to influence our behavior through taxation.

The author's recurrent theme is that the system punishes success. The code writers are like smirking sadists, sticking out their legs to trip up ambitious Americans as they feel their way through darkened rooms. Those who already have made their fortunes can afford the expertise it takes to illuminate the treacherous tax code. Woe betide the self-employed who come to the attention of the Internal Revenue Service; they soon learn what it means to be serviced by that agency of the state.

What's remarkable is that although the wealthy are in a better position to contend with the labyrinthine tax laws, they still end up paying a horrendous amount of money. The top 5 percent of earners pay half of what the personal income tax takes in. (Shlaes does not mention that fact.) The bottom 50 percent of earners pay only 4 percent of the revenue. On the other hand, the less affluent are hammered by the payroll tax. Social Security and Medicare take more than 15 percent of incomes up to about $70,000; for many people, it's the highest tax they pay. That rate is more than twice the top income-tax rate imposed in 1913!

Readers of this magazine will be cheered to see Shlaes invoke Frederic Bastiat. She quotes his insight on the "fatal illusion" that the tax burden can really be shifted to the rich. Rates and punitive measures perhaps intended only for high-income people eventually bite the middle class. Moreover, we'd all be hurt even if high taxes were imposed only on the rich, because they are the ones who save and invest the most. The income tax itself stands as a gargoyle-adorned monument to Bastiat's insight.

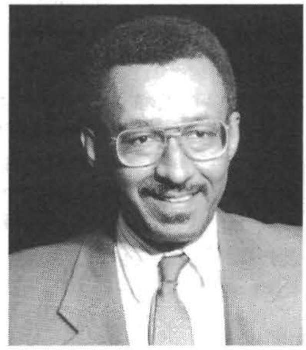
Shlaes has most of the facts and figures you'll need to appreciate the fix we're in (although there are no endnotes and in places details are scant). Considering the monumental proportions of this fix, her proposals are weak: make taxes visible, simple, as local as possible, and for revenue-raising purposes only; privatize *part* of Social Security. This is moderation to a fault.

For someone writing a book on taxes, Shlaes is strangely Pollyanna-ish: "We started the welfare state and then, when we saw it wasn't working, successfully ended it. . . . Thinkers left, center, and right agree: we don't need a nanny state." I recognized America from her description of the tax code. But those last statements made me think she was talking about some other place. □

Sheldon Richman is editor of Ideas on Liberty *and author of* Your Money or Your Life: Why We Must Abolish the Income Tax.

by Walter E. Williams

IDEAS ON LIBERTY
JULY 2000



Silly Talking

Let's talk about absolutely ridiculous pronouncements people make that either ignore simple fact or border on insanity. How about this one: Violence is no way to settle anything! Evidence suggests that violence is a very effective way of settling things. Let's look at a few examples. In 1776, violence settled whether the 13 colonies would be independent or remain under King George's thumb. In 1865, violence settled whether there'd be a Confederacy and a Union or just a Union. Between 1941 and 1945, violence settled whether Japan would control the Far East and whether Germany would control Europe. Violence settled whether American Indians owned and controlled the land now called United States or whether it would be European settlers and their progeny. In fact, violence has settled the question of land use-rights virtually everywhere.

Violence and the threat of violence not only settles questions of land use; it settles other matters as well. For example, I have no problem with paying for the constitutionally mandated functions of the federal government—those enumerated in the U.S. Constitution. But I disagree with my earnings being given to dependent farmers, failing banks, and poor people. Who has use-rights to my earnings is settled through threats, intimidation, and violence. The U.S. Congress in essence tells me, "Williams, if you do not permit us to give your earnings to dependent farmers, banks, poor people, and anyone else we deem worthy of your earnings, we will use violence to take your earnings and anything else you possess."

Some readers might think that I am being overly hyperbolic. What do you think would be the outcome of the following scenario? I write on my IRS 1040 form: "I gladly accept my responsibility to pay my share of constitutionally mandated functions of the federal government. That share comes to about one-third of what you say I owe. I will not pay for activities not authorized by the Constitution." What happens? The IRS, the agent of the U.S. Congress, levies a fine and demands that I pay all they say I owe. I refuse. Then the IRS says, "We're going to confiscate your house." I say, "No you won't; that's my house." Then they send agents with automatic weapons to take my house. I stand and defend my house. The agents of the U.S. Congress kill me.

The truth of the matter is that violence is such an effective and valuable means of settling differences that most governments demand to have a monopoly on its use.

Profiting from Misfortune

Then there's the asinine suggestion: it's wrong to profit from the misfortune of others. We can easily see how silly that suggestion is by considering what would be the effects of outlawing profiting from the misfortune of others. For example, people often experience the misfortune of breaking an arm or a leg

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skiing. Orthopedic surgeons who fix broken bones clearly profit from the misfortune of others. I bet automobile collision repair shop owners lick their chops at the news of an impending icestorm. Why? Because they anticipate auto collisions and the prospect of profiting from the misfortunes of others. As an economics professor, I profit from the misfortune that some people are ignorant of economics. So, what do you think? Should we or shouldn't we outlaw profiting from the misfortune of others?

Then there's the pious, grossly stupid pronouncement: when property rights conflict with human rights, property rights should yield to human rights. First, let's agree that property has no rights. For example, the computer I'm using to write this essay has no rights; neither does the chair I'm sitting on, nor the land on which my house is built. Only humans have rights. Among these rights are rights to property. I have rights to use my computer, chair, house, and land in any manner I wish so long as that use does not violate the rights of others.

"Rights" is a term that's fallen into harebrained usage. How many times do we hear people, particularly politicians, speak of: rights to decent housing, rights to medical care, or rights to education? These are not rights, at least not in the normal usage of the term. Rights are something that exist simultaneously among people. Moreover, rights impose no positive burden on another. For example, my rights to freedom of speech and freedom of movement exist simultaneously with your rights to the same. The exercise of my rights to free speech and movement in no way diminishes your rights to the same and imposes no burden on you except that of noninterference.

On the other hand, if it is said that I have a right to decent housing, whether I can afford it or not, since there's no Santa Claus or Tooth Fairy to give it to me, that "right" imposes a burden on you and other people in the form of taxes to pay for it. Thus, my "right" to a decent house, or anything else that I have not earned, means that someone else must have less housing or reduced rights to something that he has earned. Applying this hare-brained notion of "rights" to free-speech rights and freedom of movement would mean that for me to enjoy the right to free speech requires that you pay for the microphone, radio and television, or auditorium to enable me to speak out. My right to free movement would require that you pay my airfare and moving expenses.

A far more appropriate term for "rights" to decent housing, health care, or education is "wishes." If we used the term "wishes" instead of "rights," I would be in solid agreement with most other Americans for I too wish that everyone had a decent house, good health care, and a good education.

John Milton predicted, "When language in common use in any country becomes irregular and depraved, it is followed by their ruin and degradation." □

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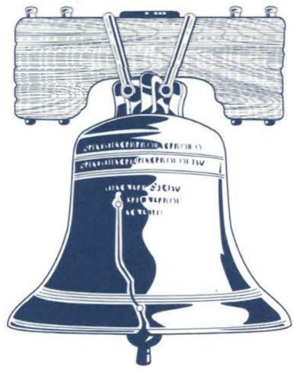

"Over himself, over his own body and mind, the individual is sovereign. In the part which merely concerns himself, his independence is of right, absolute."

JOHN STUART MILL (1806–1873), *On Liberty*

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