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John A. Davenport

Pilgrimage Among the Scribblers

John Chamberlain

AT a recent Berlin conference of the Mont Pelerin Society—that unique collection of libertarian economists and political conservatives—it was my good fortune to meet up with my friend John Chamberlain. Characteristically, he had made up his mind to come to the meeting at the last minute and, with Yankee parsimony, had chosen a roundabout route: Icelandic Airlines to Luxembourg, then a punishing bus ride to Frankfort, and finally a late Sunday afternoon flight to Berlin on Pan American (since under present insane regulations German domestic airlines are prohibited from overflying the Eastern zone). Yet at the opening reception of the conference that evening, there was John unfazed by jet lag, mixing among academics till well after midnight and exercising his art of effortlessly picking up nuggets of information from whomever he meets—nuggets which will later be transmuted into equally effortless loping prose.

This art of absorption of detail combined with unifying intellection is much in evidence in Chamberlain's new autobiography (*A Life with the Printed Word,* Regnery/Gateway, $12.95). Superficially, it is the story of how Chamberlain made his way up from cub reporter in the *New York Times* city room in the late Twenties to book reviewer and how thereafter he met the deadlines for *Fortune, Life* and many another publication. More fundamentally it is the story of how one man moved steadily from Left to Right—right politically and in the moral sense—amidst the clashing and false ideologies of our times. For anyone pon-

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dering the tragic significance of the Berlin Wall where the simple crosses mark the deaths of those seeking escape to freedom, this book is necessary and I was about to say required reading except that the latter word might offend John's sensibilities. For after all, he has emerged as one of our foremost advocates of the voluntary and cooperative society.

Such voluntarism was in full flower when Chamberlain, born in the same year in which the Wright Brothers took off at Kitty Hawk, grew up in New Haven and its environs, where he keeps a farm at Cheshire, Connecticut. In the turbulent Sixties, he recalls lending his barn to an itinerant youth seeking release from inner city pavements, only to find his acres invaded by aimless hippies and smogged, one may guess, by mists of marijuana. The incident serves as a deeper recall of the very different motivations of John's youth, when sailing in Morris Cove or expeditions to East Rock were the order of the day, leaving one too tired at night for endless and aimless palaver.

At school in New Haven John mixed freely with blacks before race became a fetish, and with immigrants of all nations—Swedes, Irish, Poles, with only the Italians still resisting the melting pot. Then on to Loomis Academy where more serious study was combined with ice skating on the Connecticut as far as Windsor Locks and canoe trips down river to Long Island Sound. Finally an extraordinary *Wanderjahr* where John and a companion first shipped to New Orleans on the steamer *Momus* and then hitchhiked across Texas and proceeded by rail to the orange groves of California in the days when there were no minimum wage laws or powerful unions to prevent motivated boys from working in the packing sheds. It was an era when, to borrow from one of Chamberlain's later books, "men were free to walk over the horizon."

His recall of his college education (Yale 1925) and of the Twenties generally exhibits the same artistry and follows the same methodology. Yale was indeed a magic place with its careless freedom, its occasional gin and orange juice parties and above all the marvelous lectures of

Billy Phelps (Tennyson and Browning), Bob French (Chaucer) and Chauncey Brewster Tinker (The Age of Johnson). Yet one thing was lacking: a grounding in the great works of political economy and the nature of government—a lacuna for which as John wisely notes, many a grad including himself were to pay dearly in future years.

In casing the Twenties, Chamberlain attacks the myth that they constituted a crass materialistic era. They were, in fact an intensely creative period as evidenced by the flowering of poetry and literature and John pays loving tribute to Edna St. Vincent Millay, Stephen Vincent Benét, F. Scott Fitzgerald, Ernest Hemingway and many another. Yet this was a time when intellectuals paid scant attention to and even despised the enterprise system which sent them to college and sustained them in Greenwich Village and Paris. When the roof fell in in '29, political thinking was already moving leftward and the literateurs fell easy prey to Marxian ideologies.

From Left to Right

Chamberlain himself was vulnerable to this Leftward swing. His first book, *Farewell to Reform,* published in 1932 when his father, a New Haven merchant, was in financial trouble and when the economy was at sixes and sevens, was a radical document, arguing not only that capitalism was non-reformable but that sooner or later the "syndicates" and collectivists would march to power. Predictably this left him open to solicitations not just from Socialists but from Communist cells even then boring from within American society. Yet bit by bit, John's Yankee shrewdness pulled him back to more solid ground, influenced, too, by discerning Trotskyites who had already taken the measure of Stalin, and later by reports of such men as William Henry Chamberlin who detailed the mass murders of the Communist Utopia.

Switching from the *Times* daily book column to *Fortune* magazine, he came to see that businessmen had something to be said for them. He was profoundly influenced by and wrote a ringing foreword to F. A. Hayek's *Road to Serfdom.* His clinching conversion to the market economy came, he writes, when on post-war assignment to Britain he discovered that while governments were very good at putting on the economic brakes, they never supplied the gasoline or leaned on the accelerator pedal for economic advance.

This negative perception turns into positive affirmation in Chamberlain's mature works: *The Roots of Capitalism* (1959) and *The Enterprising Americans* originally designed for a series in *Fortune* and later published in book form (1963), still the best history of American business on the market. Here Chamberlain, strongly influenced by the American economist Francis Amasa Walker, breaks new ground.

The true hero of the economic process is the entrepreneur, large or small, who sets investment in motion and without whom Americans might still be stalled on the Great Plains. In stressing this thought, Chamberlain anticipated by a good many years modern supply siders who place primary emphasis on motivation. The business of government is not the impossible one of planning the economic future, but rather setting the framework for creative endeavor by maintaining law and order at home and adequate defense abroad.

War and Peace

As to that, Chamberlain's reflections on foreign policy are far more diffuse and difficult to interpret than his domestic philosophy. As a child of the disillusioned interwar generation he tells with refreshing candor how he at first favored a policy of strict neutrality at the time war broke out in Europe, and only bit by bit came to see how much would have been forfeited had Britain gone down in the terrible summer of 1940 with loss of the British fleet and control of the Atlantic. With Pearl Harbor these doubts and hesitations vanished only to be replaced by arguments as to the conduct of the war and the shaping of the peace. In a chapter close to the end of his book Chamberlain, fascinated by strategy, pries into some of them: MacArthur's application of the theory of double envelopment in the Pacific, and more pertinently for anyone pondering the truncation of Europe today, General Al Wedemeyer's thesis that if only the Allies had launched their cross-Channel invasion in 1943 instead of 1944 they might have swept the Continent while Hitler and Stalin were bogged down along the Volga.

Here Chamberlain following Wedemeyer attributes the delay to Churchill's "love of empire." It seems more reasonable to suppose that in 1943 the West simply lacked the "gear and tackle" to make the Normandy landings possible. Moreover the whole thrust of Chamberlain's book suggests that ideas, no less than logistics, influenced the partition of Europe. The confusion of American intellectuals—what Julien Benda called *La Trahison des Clercs*—played a part in Roosevelt's extraordinary concessions at Teheran and Yalta. Had American public opinion taken the full measure of the Bear that Walks like a Man, Eisenhower even as late as 1944–45 might have been under firm orders to outpace the Russians to Berlin while Patton captured and held Prague.

The guardian of public opinion is,

of course, the free press and when it comes to the press, Chamberlain is fully in stride. His severest shafts are aimed at his first home, the *New York Times*, which while still an essential journal of record has fallen far from the standards of Adolph Ochs. John laments how Lester Markel finally took over the *Times* Book Review from the fairer-minded J. Donald Adams, and he faults managing editor Turner Catledge for his harboring Tom Wicker and Herbert Matthews who represented Fidel Castro as simply an agrarian reformer out of the Sierra Maestra.

With his second important employer, Henry R. Luce, John is more lenient. He himself squirmed under Luce's sudden shifts in tactics and dictates when he was writing *Life* editorials and he criticizes Luce severely for harboring so many woolly-headed Liberals in his entourage. But he concedes that Luce was truly a man of stature, and if he sometimes played with Liberals, he also harbored many a conservative—notably Whittaker Chambers who dominated *Time's* foreign news when the going was toughest, Charles J. V. Murphy who exposed the disaster of the Bay of Pigs against all the blandishments of President Kennedy, and for that matter John Chamberlain himself.

John learned to his cost just how hard it is for an editor or publisher to hold any group of journalists together—prima donnas all—when he joined with Henry Hazlitt and Suzanne LaFollette in launching the fortnightly *Freeman* in the early Fifties. The venture broke up in squabbling among friends though the name and the tradition are still carried on today by the journal for which this review is written. Nor was John's venture in editorship all lost. For from the ashes of the old *Freeman* also came Bill Buckley's *National Review* and it turned out that Buckley had the resources and the skill to give the U. S. what it most lacked: namely, a fighting weekly of opinion that melded together libertarian economics with the higher conservative values as enunciated by Russell Kirk. That synthesis in turn has not been lost on Ronald Reagan.

With Reagan's election, the autobiography ends; John Chamberlain is not one to cast the future. But in recalling the past his book surely prepares us for the days ahead and in this sense we are all in Chamberlain's debt. Meeting him again close to the Berlin Wall made me wonder how this man of so many books and columns does it. But that is of course his secret and alchemy and I sometimes doubt whether he himself could explain it. Facility, yes. But likewise integrity, humility and compassion. These are rare virtues and this is a rare and significant book.

Hans F. Sennholz

LAW and JUSTICE

JUSTICE is a cardinal virtue that renders to another what rightfully belongs to him. It is the ideal of man, the rule of conduct given to mankind. By necessity of nature man has certain rights, or claims in justice, which are moral and lawful to possess or obtain. These rights are antecedent to and independent of the state, rights which the state must not violate. In fact, the state, or civil society, is instituted to preserve these rights to its subjects, to adjudge rights as between individuals—to render justice. The idea of right and justice is the general basis of the legal and governmental institutions of what is known as Western Civilization.

The Declaration of Independence acknowledged the existence of natural rights in man and the duty of government to protect them: "We hold these truths to be self-evident, that all men . . . are endowed by their Creator with certain inalienable rights. . . . That to secure these rights, governments are instituted among men. . . . That whenever any form of government becomes destructive of these ends, it is the right of the people to alter or abolish it."

That declaration, while heard around the world, did not uproot those forms of government that make the state the sole and only source of rights. Throughout most parts of the world the source of all rights, laws and justice continued to be the king or sovereign, who derived his authority from God. The rights of the individual were dependent upon royal decree.

Various forms of modern government are built on this very philosophical concept. In totalitarian

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countries the supreme state denies the value of the individual and his rights except insofar as they may aid or assist the state. To be just is an attribute of the state; to obey to the utmost of his ability is the duty of man.

The representative governments of Western countries have been moving in the same old direction. Many now are defining justice as the freedom of each individual to exercise and enjoy all his rights *as long as such exercise does not violate superior or equal rights of others or the common good.* No longer is the individual in the possession of inalienable rights to enjoy "as long as he does not attempt to deprive others of theirs, or impede their efforts to obtain them." The state creates "equal" or even "superior" rights or defines "the common good" that takes priority over the rights of the individual.

New Rights for Old

The state creates new rights because the old rights of property are deemed to be deficient in morality and justice. Property rights are said to lead to large accumulations of wealth and "unearned incomes" while many workers are kept from keeping enough of what they produce to meet their basic needs. Property rights, therefore, must give way to the right of all members of society to subsistence, that is, to the goods and services needed to support life.

The reasoning that rejects the property rights and creates superior rights is taken from the intellectual armory of modern socialism. It is based on the exploitation theory, the concentration theory, the class-conflict theory, and other fallacious and oft-refuted notions and doctrines. And yet, their wide acceptance and great popularity have given rise to a new code of morals that bring forth the superior rights.

Men continuously recast their laws, as their notions of justice change. In the long run, laws are affected by changes in moral outlook, and laws in turn have a great influence in shaping or perverting men's sense of justice. Law and justice thus reaffirm each other in the denial of natural rights that are inalienable.

The massive redistribution system that characterizes all contemporary governments is solidly founded on modern notions of justice, which in turn are reaffirmed by the reality of law. Millions of Americans who have accepted the socialistic reasoning plead for redistribution by force because it is "just." And many more millions of Americans are accepting the system as "just" because it is the law. Altogether they comprise a vast majority eager to use the system to their own benefit.

In fiscal year 1983 the federal government, in the name of justice, is subsidizing approximately 95 million meals per day, or 14 per cent of all meals served in the United States. Through Medicaid and Medicare, it is paying for the medical care of approximately 47 million aged, disabled, and needy Americans. Through Old Age Survivors and Disability Insurance it is providing steady cash payments of up to $868 per month to 24.5 million people who are 62 or older. Federal support for the elderly will average $7850 per individual. Through the Food Stamp program it is providing assistance to 18.6 million participants. Through student assistance programs it is making available 6.9 million post-secondary awards and loans to students or their parents. (Executive Office of the President, March 12, 1982, Press Release).

All these beneficiaries are enjoying state-given rights that are superior to the inalienable rights to property. In fact, the former are resting on a denial of the latter, being financed by forced exactions from income and property producers.

Most Americans are embracing the new morality of income redistribution. But many Americans are yet aware in their working code of morals that there are contradictions and discrepancies between the new justice and the old. They usually seek to resolve the conflict of principles by adopting a double yardstick of morality: "Whatever I am receiving from the apparatus of redistribution is 'social justice'; whatever is paid to others may be unjust."

Plundering One Another

In the name of "social justice" almost one-half of the American population now are taking income and wealth from the other half. A few may still base their claims on the right to subsistence; the vast majority advance other claims based on law. The elderly who comprise some 11 per cent to 12 per cent of the U.S. population and receive 28 per cent of federal budget outlays, are entitled to the benefits by law. The law is "just" and, therefore, the individual benefits are "just." After all, they paid taxes in the past which created the legal right to benefits in the present. Young people claim the right to federal and state assistance because they are "needy" in the present and will pay taxes in the future. Both groups, and many others, fully concur on the justice of their claims because the funds are "legal" and "available."

The temptations of the law have a great influence on perverting man's sense of justice. Many individuals who are clearly aware of the double-yardstick of morality readily succumb to it as soon as they are tempted by redistribution benefits. The champion of justice in freedom and free enterprise may quietly accept the superior justice of the state as soon as he is legally entitled to

Social Security and Medicare benefits. The industrialist who throughout his successful career scorned and scoffed at the new morality may embrace it as soon as he is falling on hard times. They all have been corrupted by the new justice of income redistribution.

There are few men who choose the right with invincible resolution, who resist the greatest temptations from within and without. They do not choose to live after the world's opinion, but, in the midst of the world, cling to the principles of moral law. The world cannot do without them, but they are very odd and often troublesome to the world.

The new justice proclaimed by the state and anchored in law elevates the state and its political process to the position of omnipotent power and supreme judge. In the end, it denies and seeks to eradicate all inalienable rights while building a totalitarian order. But the justice that surpasses man's political designs can never be crushed; it springs forth again and again from the evil consequences of injustice.

What Would You Give?

IDEAS ON LIBERTY

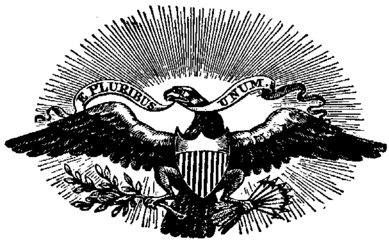
ASSUMING that you should own what you earn, then the question arises: Would you voluntarily give to government any amount of your income that it wanted, even though you knew it was going to be used for the sole purpose of subsidizing others? This is not a question of charity—how charitable you want to be—but a question of whether you would voluntarily give up the right to determine how your income, above and beyond your immediate basic needs, is going to be spent. It is a question of whether you think you should relinquish that right to certain other persons called "government," or whether you should determine the spending of your own earnings—how much for your family, how much for various benevolent purposes, and so on.

I am not asking whether you would be willing to pay for a basic protective service which government renders for you at your request. I am talking about an additional tax, on top of that, which is not for you at all, but for somebody else.

We might call one part of our present tax the *basic* tax; the additional part, a *subsidy* tax—a tax we pay in order to subsidize others.

CHARLES HULL WOLFE, "Forgotten Commandment"

Clarence B. Carson



THE MEANING OF FEDERALISM

SEVERAL developments have contributed to making the meaning of federalism obscure. Some are old, some recent. Some may be more or less innocent; others are destructive of federalism itself. One of these that may be more or less innocent is the habit of referring to the United States government as *the* "federal government." Whether it is innocent or not, it does tend to confuse the unwary. These United States have a federal system of government. The system embraces both the general government and those of the states. Thus, both the United States government and the state government are correctly alluded to as "federal" governments.

When Felix Morley called attention some years ago "to the illogical practice of referring to the central government as the 'federal government'," he declared that the confusion was "due to historical accident." What he had in mind was that the supporters of the Constitution, when it was being considered for ratification, called themselves "federalists," and the government under examination "federal." From that beginning, he thinks, the idea of the general or central government being the federal government began to take hold.[1]

That much is correct, but there is an additional reason: the Founders devised what was essentially a new system of government. It has come

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to be called federalism. But they were so intent upon promoting or preventing its ratification and acceptance that they neglected to devise logical appellations for it in general discourse. Before the devising of a federal structure, leagues or unions of more or less independent states were usually referred to as confederations. The organizations over these leagues could be referred to as confederation governments. There is a comparable word—"federation"—in use. But it would be inaccurate and misleading to refer to the United States government as the federation government. Such terminology would imply that the central government is over the states rather than over the people. Whereas, it has a jurisdiction over the people primarily.

People Are Governed

The distinctive feature of the federal system of government is that the general government acts directly upon the people. For example, the government is financed by taxes on persons, not by levies upon states. The government in question can be described with sufficient precision by calling it the United States, general, central, or national government. However, my purpose is not so much to reform the use of the language as to remove the confusion engendered by referring to it as the federal government. More on this point later.

Another source of confusion about federalism is the doctrine of states' rights, as it is commonly called. In the first place, states have powers (as do all governments), not rights. In the second place, what is being disputed within the federal system of government when so-called states' rights are asserted is the jurisdiction of the national government to act in some field. It is important that states act to restrain the national government to the exercise of its powers within its allotted jurisdiction. They are most apt to do so in defense of their jurisdiction. But what is ultimately important in this is the rights of persons and the liberties of the people. It is easy to lose sight of this when the dispute is conducted in the name of "states' rights."

Rights belong to individuals in the American constitutional system. Any government (whether state or national) may misuse its powers so as to violate the rights of persons. It is exceedingly important, then, that the rights of persons not become identified with the powers of government, either national or state. That can easily become the means for the enlargement of the powers of government (one or the other, or both) at the expense of the rights of persons. That can result from confusing either states' powers with rights or treating jurisdictions as if any power that can be conceived falls in one or the other. These are confusions of the federal system that have become implicit in the states' rights doctrine.

A Mistaken Use of the States' Rights Arguments

How easy it is to fall into this trap is illustrated in the opinion accompanying a Supreme Court decision announced in 1936. The case was *The United States vs. Butler* in which the main provisions of the Agricultural Adjustment Act were nullified. The majority opinion was written by Justice Owen Roberts. (It should be noted that Justice Roberts did not linguistically confuse jurisdiction with rights, but he did rely on the states' rights argument in such a way as to ascribe powers to the states which they neither claimed nor possessed.)

Justice Roberts based his decision upon the fact that the act provided for taxing food processors in order to purchase the compliance of farmers with the programs it outlined. His main conclusion was stated in these words: "Congress has no power to enforce its commands on the farmer to the ends sought by the Agricultural Adjustment Act. It must follow that it may not indirectly accomplish these ends by taxing and spending to purchase compliance. The Constitution and the entire plan of government negative any such use of the power to tax and to spend as the act undertakes to authorize. . . ." Then, as if it were an afterthought, he appended this dictum: "A possible result of sustaining the claimed federal power would be that every business group which thought itself under-privileged might demand that a tax be laid on its vendors or vendees the proceeds to be appropriated to the redress of its deficiency of income. . . ."[2] This last is about as close as he came to dealing with the violation of the rights of individuals involved.

Even so, he was within shouting distance of the issue in the points he made that are quoted above. But then he dragged in the dubious issue of the alleged intrusion of the provisions of the act upon the jurisdiction of the states. He went on at length about the dangers to the states of such action. At one point, Justice Roberts concluded that the "Congress cannot invade state jurisdiction to compel individual action; no more can it purchase such action." At another point, he declared that if the principle of the act were accepted, Congress could invade the reserved jurisdiction of the states and accomplish the "total subversion of the governmental powers reserved to the individual states." The proponents of the act, Justice Roberts said, were trying to claim that the Constitution "gave power to the Congress to tear down the barriers, to invade the states' jurisdiction, and to become a parliament of the whole people. . . ."[3] This claim flew in the face of the 10th Amendment, he charged.[4]

In short, Justice Roberts did his best to bring the whole weight of federalism to bear on his position with what were spurious arguments about the jurisdiction of the states. If the act was not authorized by the Constitution, it was irrelevant whether or not it violated the jurisdiction of the states. That any or all states had power to pass any such act is nowhere proved.

The 10th Amendment does not disclose a single power possessed by the states. Rather, it disposes of the question as to whether the general government has some reservoir of powers not otherwise enumerated. (It doesn't.) And, if a state does not have the power to pass such an act, it would be no trespass upon its jurisdiction for the general government to pass one. He does not even explore the possibility that the states might be prohibited from passing such acts by the United States Constitution, for which an excellent case could be made. The most that can be said for the argument is that Justice Roberts grabbed the states' rights ball when it came floating by and ran with it with all his might.

None of this is said in derogation of jurisdictional claims of the states, of the decision the Supreme Court reached, nor of the powers of reasoning of the court. Rather, it is to illustrate the results of the confusion of federalism inherent in the states' rights doctrine and some of its corollaries.

Subordinating the States

But the greatest confusion about federalism and threat to its survival has come from the concerted effort for more than half a century to turn the states and their dependent organizations into administrative units of the national government. The way was eased for this by the habit of referring to the national government as *the* "federal government." Off-the-mark talk about states' rights has had little more impact than dogs have upon the moon by barking at it. State organizations have been most effectively turned into administrative units in connection with the development of the welfare state.

More precisely, as the national government became more and more involved with redistributing wealth, state organizations, particularly counties, became instruments of much of the distribution. For example, state welfare agencies (called by a multiplicity of names nowadays) administer a great variety of programs funded by the national government. Over the past three decades, too, the courts of the United States have asserted increasing and widespread authority over agencies funded primarily by the states, such as schools, prisons, mental institutions, colleges, and what have you.

There should be no doubt that there have been large scale intrusions upon the jurisdictions of the states.

The confusion has been further compounded in recent years by what has been called the "New Federalism." Currently, the phrase is being used by the Reagan Administration to designate the plan to turn over some welfare programs to the states, to disentangle some state-national joint efforts by having the national government take over the funding of them entirely, and to reduce national controls over grants made to states by the government. But the idea of a New Federalism had been around for several years before Reagan became President.

The late Nelson Rockefeller proposed doing something to revive federalism in a book published in 1962, entitled *The Future of Federalism*. At the beginning of his second term, President Richard Nixon advanced the idea of having the national government aid in the recovery of federalism. About all that came out of that was the practice of providing large grants from the central government under the rubric of revenue sharing. What these various proposals and plans have in common is the notion that federalism can be restored to its full vitality by action of the national government. That may well be the problem rather than the solution. At any rate, it has succeeded thus far more in confusing than in clarifying the meaning and function of federalism.

The main point I wish to make about the function of federalism is that it is a system for the protection of the liberties of people and the rights of individuals. The freedom of a people consists in the voluntary use of their property and faculties to their chosen ends. The Founders of the United States generally understood well something that is universally the case: that government is ever the greatest potential threat to freedom of action. The liberties that prevail consist of those acts not prohibited by law and those rights of individuals that governments are forbidden to violate and are enjoined to protect from all intruders. In short, the precondition of extensive liberty for a people is limited government. It is, then, as a device for limiting government that a federal system of government performs its most valuable function. But to grasp the full implications of this, the meaning of federalism needs to be clearly stated as free of confusion and complications as possible.

Two Governments in Power

A federal system of government is one in which two governments have jurisdiction over the inhabitants. In this country, the two governments are those of the states and of the United States. Both governments have sanctions, that is, may use force upon the inhabitants. Both have enforcement officers and courts. This system is sometimes referred to as one of dual sovereignty. The phrase is, however, misleading, and when carried very far leads to conflicts for which there is no resolution short of the destruction of such independence as one or the other governments may have.

The term sovereignty came into currency in the modern world in the 16th century. Monarchs came to be referred to as sovereigns. The concept was used to buttress absolute monarchy. It means the supreme, or ultimate authority, over a land, state, or country. The United States does not have a monarch, or king; literally, it does not have a sovereign. It goes deeper than that, however. Neither the Constitution of the United States nor the constitutions of the states vest supreme authority in any man, any group of men, or the people as a whole.

It is the genius of American federalism that government is limited, not supreme. Sovereignty is a mischievous notion, an improper analytical tool for describing government in this country. It sends people in quest for an authority which can only exist in defiance of the constitutions of the states and of the Constitution of the United States.

Federalism is best understood, not as a political concept, but as a legal concept, which is what it is. Sovereignty is a political concept (an absolutist authoritarian one, at that); jurisdiction is a legal concept. Thus, the conclusion that in the United States the states have a jurisdiction, and the United States has a jurisdiction.

Defining the Jurisdiction

The Constitution of the United States, aside from describing the method of selection of its officers and the inner workings of the government, is mainly concerned with defining the jurisdiction of the government that it authorizes. Also, it denies jurisdiction to the states in certain areas, prohibits states to act in certain ways, and reserves powers to the states, and rights to the people. Before offering some proof for this and delineating the jurisdictions, however, there are two basic points that need to be nailed down.

The first is to show why state governments are federal governments as well as the United States. These United States have a federal system of divided jurisdiction in government. Severally, the states exercise authority over persons in one of these jurisdictions. The United States government exercises authority in the other. Both, therefore, are federal governments. To acclaim one as the federal government to the exclusion of the other is to deny, implicitly, that we have a federal system of government.

The other point has to do with the independence of the state governments of the central government and the powers of action independent of state governments by the United States government. That is not to say that each does not rely on the other in important ways—they do—but to affirm that their operations as governments are independent. Indeed, the independence of the states stands on more solid historical ground than does that of the national government.

James Madison noted that in this and several other matters, "The State governments will have the advantage of the federal government." As proof, he pointed out that "The State governments may be regarded as constituent and essential parts of the federal government; whilst the latter is nowise essential to the operation or organization of the former." His meaning was that elections occur within states, and that the general government depends upon the states to come into being. "On the other side," he continued, "the component parts of the State governments will in no instance be indebted for their appointment to the direct agency of the federal government. . . ."[5] Moreover, some of the states existed before the United States. True, after the adoption of the Constitution, states are admitted to the union by act of Congress. But they come into being at their own instance, draw up their own constitutions, and select their own officers. Their independence of the general government, then, is antecedent to it.

The important point, however, is that both the government of the union and the states are distinct and separate entities. They are governments in their own right, neither being the creation of the other. Devotees of the states have sometimes argued that the United States was created by the states.[6] Not so, however. The states did send delegates to the Constitutional Convention, and they did hold elections for the consideration of ratification of the Constitution. But the latter delegates were chosen by the electorate, and the preamble to the Constitution refers to "We the people" as the origin of the government. In any case, both governments possess the essentials of separateness, distinctness, powers, and independence to be considered governments in their own rights.

Local Governments

By contrast, local governments are not independent governments. Except for the District of Columbia, all local governments are creatures of the states. They come into being by authority of the states, and derive such powers of governments as they exercise from the states. They are not, then, a part of the federal system of government, but rather a part of state government. Or, to be absolutely precise, they are linked to federalism only by their ties to state governments.

If the independence of the state and United States governments were all that could be said about federalism, however, it would be a fearful and monstrous system of government. To have one independent government over the inhabitants is bad enough, but to have two would be intolerable, if each or either could exercise its power without restraint. That is not the case, however. Both governments are restrained, restrained by each other by the delineation of their separate jurisdictions, the denial of powers to one or the other or both, and by the specified manner in which they are to exercise their powers. Their independence of each other is important, because it provides a safeguard against intrusion by either into the jurisdiction of the other. But it is of even greater importance that in the assignment of jurisdictions both governments are limited and restrained. It is these restraints that protect the liberties of the people.

The bulk of these restraints are found in the United States Constitution. In the first place, the United States government was never granted all the powers that it might be claimed are inherent in government itself. It was granted only a limited jurisdiction to deal with certain objects of government. These powers were described in general terms in the following ways at the time of the debate over the ratification of the Constitution. John Jay, speaking in the New York state convention, maintained that the powers were largely restricted to the following objects: "They comprehend the interests of the states in relation to each other, and in relation to foreign powers."[7] James Madison observed that "the powers of the general government relate to external objects and are but few."[8] Again, he emphasized that "The powers delegated by the proposed Constitution to the federal government are but few and defined."[9] In the Virginia convention, Edmund Pendleton argued that the general government was to act "in great national concerns, in which we are interested in common with other members of the Union. . . ." At another point, and more heatedly, he insisted that the government authorized was not clothed with all powers of government. "It only extends," he said, "to the general purposes of the Union. It does not intermeddle with the local, particular affairs of the states."[10]

Specified Limited Powers

It is not necessary, however, to rely solely upon the comments and descriptions of contents by the Founders to learn that the Constitution granted only limited powers to the general government. The document speaks for itself in this regard. The powers of the government were enumerated in several places in the Constitution, above all, in Article I, Section 8. For example, such powers as these are granted:

> To define and punish Piracies and Felonies committed on the high Seas and Offences against the Law of Nations.
>
> To declare War, grant Letters of Marque and Reprisal, and make Rules concerning Captures on Land and Water.
>
> To raise and support Armies. . . .
>
> To provide and maintain a Navy.
>
> To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States.

In the most general terms, then, the Constitution provided for a general government to conduct foreign relations, to settle disputes among the states, and to facilitate trade and intercourse among the peoples of the states.

Further, the United States government is prohibited to do some things. For example, "No Bill of Attainder or ex post facto Law shall be passed." "No Tax or Duty shall be laid on Articles exported from any State." "No Title of Nobility shall be granted by the United States. . . ," and so on. The government is further restricted by amendments, such as the Fourth, which reads: "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched and the persons or things to be seized." Beyond all these, there is a blanket limitation contained in the 10th Amendment: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

Limits to State Powers

The jurisdiction of the states was conceived as being much more comprehensive than that of the United States at the time of the drawing of the Constitution. The Constitution does prohibit certain powers to the states. For example, "No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin money, emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility."

There are further prohibitions on the states in amendments, the most general of which are to be found in the Fourteenth, and the central ones are embodied in these words: "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." Beyond such prohibitions, however, the main powers of government over the lives of persons were reserved to the states.

James Madison stated the case for the residual powers of the states this way. "Those which are to remain in the State governments are numerous and indefinite. . . . The powers reserved to the several States will extend to all the objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the State."[11]

State Constitutions Also Limit

It should be noted, however, that the states are further restrained by their own constitutions, and most of these have much more extensive restrictions than are contained in the United States Constitution. Moreover, as already noted, since the time of Madison, further extensive prohibitions on the states have been added to the Constitution. Thus, it is correct to say that both the United States and state governments are limited and that neither possesses all those powers which may be conceived as inherent in government itself.

The object of this limitation, indeed, the highest object of federalism itself, was the rights of individuals and the liberties of the people. Alexander Hamilton put it this way: "This balance between the nation and state governments ought to be dwelt on with peculiar attention, as it is of the utmost importance. It forms a double security to the people. If one encroaches on their rights, they will find a powerful protection in the other. Indeed, they will both be prevented from overpassing their constitutional limits, by a certain rivalship, which will ever subsist between them."[12]

From our perspective, it is easy to conclude that Hamilton was wrong, at least in part, in his prediction. He was right, of course, in holding that the national government would defend its jurisdiction from intrusion by the states. He was right, too, in maintaining that this would provide security against states' encroaching upon the rights of the individual. It has worked that way historically, and it is still working that way. But what of that "rivalship" of the states over their jurisdiction and the security that was supposed to afford against concentration of power in the central government and its violation of the rights of the people?

Aside from clamors about "states' rights" and an occasional suit by some state in the courts of the United States, the states appear to be paper tigers. They are largely unable either to protect their own jurisdiction or the rights of their inhabitants from the central government. Either Hamilton was wrong or something has happened in the interval.

An Important Balance

It will be my position that Hamilton was right about the Constitution as it then stood. To understand why, it is necessary to look at the structure of the government and how it has been changed so as to effect the power of the states to defend their jurisdiction. The answers to two questions should lay open to view the crucial structure of the government. First, what branch or organization in the central government was crucial to the defense of the jurisdiction of the United States? While all the branches play a role in it, the ultimate power for the defense lies in the Supreme Court. By its power of review of legislation, both national and state, where a constitutional question is raised, it can vigorously and effectively assert and defend the jurisdiction of the United States.

Second, in what branch of what government is there an organization with the power and under the control of the states to defend the jurisdiction of the states? There is no such organization today. There has not been one in the United States since 1913. Until 1913, the United States Senate had power to do it (and it still does), and state legislatures had crucial leverage over the Senate. That leverage was removed in that year by the 17th Amendment. The amendment provided for the direct election of Senators.

In the original Constitution, Senators were elected by the legislatures of the states. In effect, the state governments had representatives in Congress; they were the members of the Senate. The Senate is well placed in the government to defend the jurisdiction of the states, if it will and must. It can refuse to pass any bill which intrudes upon the jurisdiction of the states. Moreover, Supreme Court, indeed, all court, appointees of the United States government, have to be approved by the Senate. Presidents, too, have large incentives to get along well with the Senate, for all their major appointees and all treaties must be approved by the Senate. Further, trials of impeachment, including judges, are conducted before the Senate.

Since 1913, state legislatures have had little or no effective control over Senators. No longer do they have to please the state legislatures to be reelected. State governments are no longer represented in the central government. It is not surprising, then, that the great growth and expansion of power of the national government have occurred since 1913. The main balance wheel for the states in the Senate no longer operates to restrain it. The courts have ever more vigorously asserted and expanded the jurisdiction of the United States, and the presidents and Congress have not been far behind.

That is not to say that federalism is meaningless today. It is still used to restrain the states. Moreover, the states still retain much jurisdiction, or portions of it, thanks largely, I suspect, to the voters. But the central government is no longer restrained significantly by federalism. It has become *the* government, indeed, *the* federal government, as we acknowledge in our references to it.

If the above analysis is correct, federalism can hardly be restored by redistributing welfare programs. It will hardly be revitalized, in any case, by federal aid or revenue sharing. It will only be able to perform its salutary function of protecting its jurisdiction so as to defend the rights of its inhabitants when it has a means for doing so within the general government itself. Looked at that way, the election of Senators by state legislatures was a good idea.

—FOOTNOTES—

[1]Felix Morley, *Freedom and Federalism* (Chicago: Henry Regnery, a Gateway edition, 1959), p. 21.

[2]Henry S. Commager, *Documents of American History,* vol. II (New York: Appleton-Century-Crofts, 1963), p. 251.

[3]*Ibid.*, pp. 251–52.

[4]*Ibid.*, p. 249.

[5]*The Federalist Papers,* Willmoore Kendall and George W. Carey, intro. (New Rochelle, N. Y.: Arlington House, n. d.), pp. 290–91.

[6]See, for example, James J. Kilpatrick, *The Sovereign States* (Chicago: Henry Regnery, 1957), p. 4.

[7]Elliot's *Debates,* Bk. I, vol. 2, p. 283.

[8]*Ibid.*, vol. 3, p. 259.

[9]*The Federalist Papers,* p. 292.

[10]Elliot's *Debates,* Bk. I, vol. 3, pp. 40, 301.

[11]*The Federalist Papers,* pp. 292–93.

[12]Elliot's *Debates,* Bk. I, vol. 2, pp. 257–58.

American Federalism

IDEAS ON LIBERTY

IN its narrower sense, federalism refers to the division of authority and function between and among the national government and the various state governments. But it has come to possess a wider meaning in American political history. The idea of constitutional limitations of power, of both horizontal and vertical divisions of power, of the representative nature of republican institutions, and of a national government strong enough to perform certain necessary tasks and yet not so strong as to become a threat to liberty, is perhaps better epitomized in its unique American historical setting by the word federalism than by any other single term.

GEORGE C. ROCHE III

Elgin Groseclose

MANNING THE SEA WALLS

THE rising tide of foreign government defaults on their overseas, dollar-denominated debt threatens to break and overflow the sea walls of international banking and inundate the capitalistic world.

The recent Toronto convocation of international bankers for the annual meeting of the World Bank and International Monetary Fund considered the approaching flood, but their efforts were like those of a platoon of Dutch school boys recruited to stick their fingers in the leaking dykes. In desperation they shouted for more bags of the sand that was being washed away; that is, more international credit, more fiat money of the sort that was already being diluted into muddy liquid.

For the United States, with business bankruptcies soaring and the banking system tottering, confidence has begun to ebb in the power of the omnipotent Federal Reserve to control the flood. Although it mans the sluice gates of a mighty reservoir of credit, some see cracks in the great dam below which the economy sits like a present-day Johnstown. One journalistic commentator declares that the country faces its greatest economic crisis in fifty years.

The Great Debate

A popular cry is to denounce Reaganomics with its devotion to free market economics; more radical theorists accuse the capitalistic sys-

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tem and argue for authoritarian communist and socialist forms of government.

Advocates of more government intervention, however, face the dilemma that the crisis is severest in the Third World, most of which is governed by Marxist or socialistic principles under authoritarian regimes. Indeed, it is the collapse of Third World economies, despite a thirty-five year drain of Western resources under various foreign aid programs, that has complicated the problems of the West; it is the defaults of Third World countries on loans from Western banks that now threaten the international banking structure.

Advocates of more government subsidies and intervention, however, ignore the fact that if Reaganomics has not borne the expected fruit, it is because of its failure to extend free market principles into the most important area of enterprise—the money system.

Despite dismantling of many government barriers to trade, money—which is the lifeblood of enterprise—remains under authoritarian controls by a bureaucracy as aloof, as unrestrained, as a Soviet Politbureau. This is the Open Market Committee of the Federal Reserve which congeals the wisdom of twelve mortal beings enjoying long tenure into directives as to the amount and direction of money flow; each Friday the markets of the world await with bated breath the effect of their deliberations.

Historical Review of System

The development of this autocratic power was gradual and often unperceived. For twenty-seven centuries, mankind regarded as axiomatic that the only valid means of payment is intrinsic money, that is, coinage. Rulers throughout history, however, have wherever possible circumvented this principle by degrading or counterfeiting the coinage. The most pervasive effort was in 13th-century China, when the Mongol emperors substituted paper notes for metallic coinage in circulation. The Venetian traveler Marco Polo admired the device which, he noted, gave the emperor enormous profits. Despite the inflation that followed, with the notes at a discount, the practice spread to Europe; but in the Middle East, efforts to introduce paper notes were resisted by sedition, and in India, silver remained the standard money of account until the British introduced paper in 1893. The British paid the price; within 20 years they nearly lost their colony but for a U.S. rescue operation. Iran had only metallic money until the 1930s when Reza Shah introduced central banking, *a la* the Federal Reserve; this monarch lost his throne before a decade had passed.

Rise of "Scientific" Economics

The framers of the United States Constitution rejected paper currency, but despite Constitutional doubts, paper currency was introduced as a war measure during the Civil War; specie payments were resumed in 1879.

Meantime, there had been growing up in the 19th century a school of thinkers employing the concepts of mathematics and physics; they obtained respect for their novel theories by designating them as "scientific." Karl Marx called his theory "scientific socialism." Their view was that man was a creature of physical wants and demands that could be measured statistically and programed mathematically. The profession acquired status after World War II by the formation of an official Council of Economic Advisers, enjoying access to the head of state and more influential than the Secretary of the Treasury or the Secretary of State. Added prestige came in 1969 when a Nobel Prize in "economic science" was set up along with those in medicine and physics.

From this new profession came the philosophical framework for fractional reserve currency which came into being in 1913 with the Federal Reserve System. With fractional reserve currency, the Reserve banks were authorized to convert into cash the debt of member banks. In exchange for the member bank's paper the Reserve banks could issue legal tender notes up to 2½ times the amount of gold money held by the bank. The process was called discounting.

At first only short term commercial debt was generally convertible to cash, but such was the leverage given by this new mechanism, such was its power to create purchasing power by the stroke of a pen, that pressure for its expansion became irresistible. Government bonds became acceptable collateral—this helped finance World War I—the kinds of debt expanded; if not enough debt were offered for discount the Reserve, through the Open Market Committee, could go into the market and buy up debt either on the excuse of stabilizing the price level or of promoting employment. Eventually the requirement of a gold reserve was abandoned.

The Inflationary Flood and the Economic Consequences

The commercial banks, with this ever-ready fountain of liquidity, expanded their lending to the limits of their capital reserves. These dropped from around 25 percent of assets to currently less than 10 percent, with the 15 largest banks presently operating on margins of less than 5 percent.

Not finding productive use for this financial power, they have financed a rank and unhealthy growth of corporate conglomerates with an economic justification no one has yet been able to define. The system of fractional reserve currency became a world fashion like the current rage for blue jeans and lettered T-shirts that may be found on the Ginza and in Red Square. Countries, from Italian principalities governing only a mountain top to continental empires like China, engaged in the issue of currency through central bank emissions.

Despite the collapse of the system in 1933, when every bank in the country closed its doors, such is the fascination with fiat currency that ever-wider powers were conferred on the System. In 1980 Reserve banks were authorized to convert to cash practically any collateral they pleased. Under this authority, the Reserve has acquired some $2 billion of foreign government debt, and it is now being pressed to liquidate large chunks of the debt owed to United States banks by Poland, Mexico and others. Only John Law, in his effort in 1729 to turn the soil of France into money, showed such effrontery.

Despite the evidence that the main cause of the current world-wide economic debauch is fractional reserve currency adopted everywhere, the Secretary of the Treasury continues to voice confidence in the System. The President tentatively suggests that it should be brought under Treasury supervision. This would be disastrous.

The correct course is to dismantle the Federal Reserve System.

True Function of Money

The function of a monetary system is not to manipulate the flow of credit and banking transactions to maintain a given, or even stable, price level; nor is the function to create employment. The money system should be managed neither in the interest of creditors nor of debtors; neither in the interest of producers nor consumers; neither in the interest of government nor of taxpayers. The function of government is to maintain the integrity of the standard; its function toward money is the same as toward the measure of length or of weight or of quantity. It is as corrupt to vary the standard of value and deferred payments as to change the length of the yard in the interest of cloth merchants, or the content of a bushel in the interest of wheat farmers.

The means of maintaining the standard is the definition of the dollar in terms of a given weight of silver or gold; since 1900, the sole metal of the standard has been gold; the dollar is still by law and statute defined in terms of gold. The regime under which the money system has been corrupted came to a climax in 1934 when the mint was closed to the free coinage of gold. The mechanism by which the circulation is always adequate to the needs of trade is that of free coinage. Under free coinage anyone can bring gold to the mint and have it coined only for the cost of mintage. Under this system the free market, rather than a bureaucracy, determines the amount of circulating media.

Restoration of Free Coinage

The system of free coinage was established in England in 1666; for the first time in history the government monopoly of money ceased; during the succeeding centuries, gold flowed to England, the circulation was always adequate, and England rose to be the principal commercial power of the world. The same system was adopted by the newly formed United States, and under this system the United States became the only rival of Great Britain as a commercial and industrial power. This is the system that should be re-established to restore stability in the United States. It is no more necessary for an international agreement to this end, as some argue, than for every country to agree on the length of a meter or the weight of a kilogram; the natural effect of integrity will compel them to do so.

Monetary Manipulation

IDEAS ON LIBERTY

IF the nineteenth century was an era of the gold standard, free trade, and monetary stability, the twentieth century has been an era of managed currency, protection, and monetary instability. This instability—i.e., violent inflation—has boded ill for international trade, which wholly depends on international payments. Inflation—the expansion of money and credit—distorts "official" exchange rates. Domestically, it tends to set in motion a flight from currency into goods. Externally, it tends to cause another flight: a flight of "hot money" fleeing to foreign sanctuaries where inflation is relatively quiescent. Inflation ultimately causes domestic prices to rise with the result that foreign importers are strongly inclined to shop harder for better bargains elsewhere. . . .

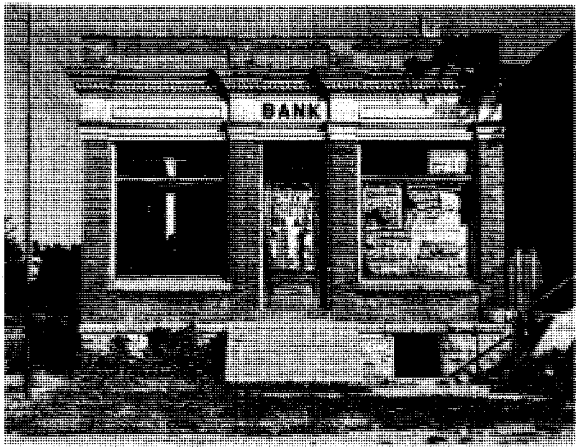
The past generation has been one of fantastic inflation the world over. Governments spend and spend, pumping out ever more money. One Keynesian admitted in the London *Economist* a few years ago: "Inflation is nine-tenths of any practical full employment policy."

Inflation, in short, is the handmaiden of exchange control and protection. It generally spells death for free trade.

WILLIAM H. PETERSON, "Barriers to World Commerce"

Bill Anderson

BOOM and BUST



IN THE COURSE of discussion about the pros and cons of free enterprise, the subject inevitably seems to turn to the business cycle. Capitalism's critics—and there are many—waste no time in decrying the alleged "instability" of the free economy, a system that they claim allows a few to garner great fortunes while leaving the masses to lurch from semi-poverty in good times to squalor in depressions.

Notes a business columnist of a major U.S. newspaper:

> Unbridled supply-and-demand ideas led to great wealth, but also great poverty, in the late 1800s and early 1900s. There were also periods of great economic boom and bust, of which the Great Depression is the best example. The Western nations grew tired of waiting for supply and demand to work everything out, and along came Mr. Keynes and his ideas for them to grasp.[1]

At this writing, the United States is suffering from its eighth recession since World War II, an economic phenomenon that is again leading persons to question the qualities of capitalism. Politicians, believing the nation can be taxed into prosperity, claim it is once again time for the government to "take over" the reins of the economy. As an influential U.S. economist has written:

> We need an increased degree of government selection of priorities, channeling of funds in the direction of those priorities and a recognition of a need for

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some kind of planning by the federal government. Even some members of the corporate community now say that free markets, such as they are in the United States, are not doing the job.[2]

Economists, journalists, intellectuals and politicians seem to agree that the free economy is indeed the source of boom and bust, of recession and depression. If the economy is left without the guiding hand of state direction, they believe, the forces of supply and demand will eventually self-destruct, leaving a wreckage of vanished fortunes and massive unemployment. And should the economy go into recession, they say, the central government should immediately launch programs of transfer payments, public works and business bailouts to stem the tide of the slump.

Liberals are not the only persons to advocate such centralized measures for dealing with economic downturns. Conservative economists all too often accept the business cycle as an inevitable price of capitalism's success and look to the state as a source for minimizing the trauma caused by recession. The public understanding seems to be that the business cycle, in a capitalistic economy, is simply a fact of life that cannot be any more avoided than winter in New Hampshire. Discussion of the business cycle, then, centers not on preventing it, but, rather, as Keynes suggested, on using government monetary and fiscal policy to allow for a smooth transition from one end of the cycle to the other.

The Great Depression

When the *causes* of business cycles are discussed, the subject is usually the Great Depression from 1929 to 1941 (although diehard believers in Franklin D. Roosevelt insist the depression ended in 1933 with FDR's ascension to the Presidency). Yet, the Great Depression had similar characteristics to the so-called panics or crises that had occurred in the United States and abroad in the previous century: a period of boom—accompanied by inflation—then a sudden and violent bust with prices and wages dropping quickly and banks and other businesses going belly-up.

Because the boom-and-bust periods in American history have had such similar features, it would seem best to study the general causes of those economic phenomena rather than to concentrate on only the Great Depression. However, since it took far longer for the U.S. economy to work its way out of the slump in the 1930s than it had in previous bad times, this essay will also look at what set the Great Depression apart from its predecessors, along with examining the business cycle since World War II.

In examining the stated causes of the business cycle, one finds two explanations that stand out. The first is the traditional one—which includes socialist and Marxist variations—and the second is the Austrian Malinvestment Theory. There is also a third explanation, one that deals with the so-called "instability" of capitalism, that will also be examined.

American history textbooks are rife with explanations of 19th-Century recessions that center on "overexpansion" of the railroads or troubles on the farm. The idea, of course, is that a recession begins within a certain sector of the economy and snowballs into other areas, pulling them down as well.

> In the industrial society, because of the unusual acceleration which takes place in durable goods, *the results of individual freedom are more complicated and far reaching* (italics mine). Assume that each year twenty million men's coats are sold, produced by 210,000 machines, each of which can make only 100 coats a year . . . with a ten percent increase in the sale of coats, there is a one hundred percent increase that year in the machines needed . . . When the demand for a product drops, however, the snowballing effect begins . . . he lays off his workers, whose own buying power is now greatly reduced, thus affecting other businesses . . . and the downward cycle is accelerated.[3]

While the above explanation of the business cycle may seem viable to publishers of history books, it, in reality, is wracked by fallacies, the first being the informal fallacy of *converse accident* or hasty generalization. The author assumes that because one particular industry goes bust, all the other industries will topple as well, a sort of business domino theory. However, the demise of one industry may only be signaling the rise of another. For example, to use the coats again, should there be a lessening of demand for a certain brand of coats, the change in consumer taste may be only because another brand of coats is less expensive or more attractive. Or, perhaps, the entire coat industry in an area has lost its market because the surrounding temperatures have permanently risen 30 degrees, which might mean a subsequent boom in the sun dress and bathing suit industries.

The Fallacy of Composition

Whatever the reason for the demise of one industry, there is nothing in economics that suggests that the general economy will collapse because one sector loses its appeal to consumers. As economist Lawrence Reed has pointed out, to hold that what might be true for one individual is also true for all others is to commit the fallacy of composition.[4] For example, lobbyists in the home building industry recently persuaded Congress to approve a $3 billion housing bail-out bill to prop up that recession-torn sector for another year (fortunately, President

Reagan vetoed the bill). Construction lobbyists and their supporters argued that the general economy was sick because the housing market was slow, and, therefore, a general recovery could only be precipitated by giving an artificial boost, via inflation, to housing. Again, we were presented with the fallacies of converse accident and composition, this time in reverse.

The traditional explanations to the business cycle are more endemic in economic circles, with socialist and Marxist theories, it seems, being drawn from this area of thought. These arguments center around the idea that downturns in the business cycle result from a shortage of money. In pre-capitalist times, as Henry Hazlitt writes, "Whenever business was bad, the average merchant had two explanations at hand: the evil was caused by a scarcity of money and by general overproduction."[5]

This argument has since been refined by socialist and liberal critics of the marketplace, and, indeed, has become the standard fare when explanations for the business cycle are sought. In examining this argument, it is necessary to study not only the ideas of theorists in pre-capitalist times (and the disastrous results of their "solutions"), but also the socialist and Marxist notions and why they are fallacious.

Economic historians are all too aware of the problems of the French economy during the early years of the French Revolution. In 1789, business was slow. Merchants and politicians in the National Assembly demanded that the government solve the nation's fiscal problems (which were due to a top-heavy government debt). In seeking a solution that fit with the economic thought of the times, the French Government floated massive amounts of paper money to give its citizens "purchasing power." What resulted from this action, of course, was a wild hyperinflation that destroyed the French economy, helped bring about the famous "Reign of Terror" and ultimately led to the dictatorship of Napoleon. The French leaders in 1789—as well as most government officials since then—assumed the fallacy that money is wealth, a notion that was exploded by Adam Smith in *The Wealth of Nations* when he pointed out that wealth comes not from money but rather from the increase of desirable goods and services.[6]

The Labor Theory

Socialists, beginning with Karl Rodbertus and Karl Marx in the mid-Nineteenth Century, have built many of their anti-capitalist arguments upon the fallacy of money being wealth. For example, in his famous *Overproduction and Crisis,* Rodbertus declared that production was solely for profit and that all production was simply a result of the efforts of labor or the workers.

> This standard socialist doctrine, when joined with his beliefs on diminishing wage share,[7] led him to a theory of crises. All wealth being a product of labor, the laborer with his declining wage share was unable to buy back the products he produced. Markets would be flooded with goods which would bring falling prices and unemployment and, finally, precipitate an economic crisis. To relieve the situation, Rodbertus proposed that the state take over.[8]

This general crisis that Rodbertus predicted was the same sort of crisis Marx predicted for the advanced capitalistic West; he emphatically believed that, as production of goods and services increased, the profits of the "capitalists" would increase, wages would fall and the laborer would be unable to purchase those products that he had created with his own labor. Such would be the crisis that would ultimately lead to the workers revolting against their "masters" and leading the western world to communism.

The influence of Rodbertus and Marx is still felt strongly today, especially when leading writers and intellectuals explain their pet causes for the Great Depression. Declares Michael Harrington, who heads the Democratic Socialist Organizing Committee:

> The Great Depression discredited Say's Law (which, in short, declares that supply creates its own demand). During much of the 1930s, there was a glut of consumer goods because workers lacked the purchasing power [i.e., money] to buy back what they produced. That was why government began to play a role in the economy on behalf of middle-and-low income people during the period of Franklin Delano Roosevelt's New Deal.[9]

Says *Time* magazine:

> Economists debate to this day about what caused the Great Depression. A prevailing view, persuasively argued by John Kenneth Galbraith, is that the technological increases in productivity throughout the 1920s (up 43% per factory man-hour) were not matched by increases in wages and thus in the public's capacity to consume (factory pay rose less than 20%). The collapse of the overinflated stock market therefore started a downward spiral in both demand and ability to pay. Conservative economists like Milton Friedman, on the other hand, blame the Federal Reserve System for failing to expand the money supply sufficiently in the wake of the stock market crash.[10]

Friedman vs. Galbraith

Although Milton Friedman and John Kenneth Galbraith lead schools of economic opinion that vastly differ with each other, one cannot help but note at least some similarity between the two men's reasons for the coming of the Great Depression. Galbraith believes—as do most modern historians and intellectuals—that Ricardo and especially

Rodbertus were correct: production growth outstripped wages, which meant the laborers' wealth diminished while the capitalists' or owners' profits increased. Or, to put it in more familiar terms, the rich got richer and the poor got poorer. To rephrase Harrington, the workers were drained of purchasing power, which was siphoned off by their bosses.

While Friedman certainly is no advocate of the above theories, his explanation of the Great Depression ultimately implies that the Federal Reserve System did not *inflate enough* (i.e., put "purchasing power" into the economy) from 1929 to 1933. So, viewing the causes of the Great Depression from the angle of the major schools of economic history, it can be said that the economic downturn happened because the printing presses of the federal government did not turn fast enough to enable people to hold enough "money" in their hands to "buy back" enough of the products that they had created.

Of course, Galbraith and Harrington—unlike Friedman—have argued that in addition to inflating, it is the duty of government also to heavily tax those in upper income brackets and give the revenues to those in lower brackets to insure that people "on the bottom" would have enough "purchasing power" to consume, thus avoiding "a glut of consumer goods."

Implied in the traditional and socialist interpretations of the business cycle, of course, are the notions of overproduction and underconsumption, fallacies that have remained with us to the present time.[11] But whatever the line of interpretation, be it lack of "purchasing power," overproduction or underconsumption, the theories still abound with fallacies and false assumptions of the economic system.

"Money Is Wealth"

The first fallacy, as I have already stated, is that *money is wealth.* When Galbraith and Harrington dolefully observe the rate of production outstripping the growth of *money wages,* they have immediately jumped to the conclusion that buying power has diminished. Nothing could be farther from the truth. Such a view suggests that wealth causes poverty, or, in other words, a society becomes poorer as it produces more wealth.

The vast increase in production in the 1920s—and, indeed, through most of the industrial age in our nation's history—served to *bring down* prices as goods and services became more abundant and thereby more accessible to the masses. For example, the automobile, once a plaything available only to wealthy Americans, became a staple in households with the advent of mass production. In the past decade, we have seen electronic marvels such as the pocket calculator evolve from extremely expensive but inefficient solvers of mathematics problems to the $10 models that are far superior to their predecessors (and this improvement in quality and decrease in price has come in the face of the galloping inflation of the past 10 years).

The socialist viewpoint fails to recognize that wealth is a variable of production of goods and services, not of production of money. Any government on the earth can quickly crank out a vast increase in the supply of its designated means of exchange (provided that means is paper money or base-metal coins, not valuable commodities) and many governments, including our own, have done just that. But the sad lesson is, though few politicians and intellectuals have realized it, that inflation does not bring increased wealth, but rather chaos and, in the end, more poverty.

Burdening the Poor

Another important criticism of the socialist notion that the increase in production "makes the rich richer and the poor poorer" is that history has shown this view to be utterly false. Even one historian whose text is laced with anti-free market rhetoric concedes that standards of living for ordinary workers rose during the 19th Century, the time when Rodbertus was claiming that the opposite was true.[12]

In order for the socialist argument to be true, the lot of the average person today would have to be far worse than the lot of the average worker *before* the Industrial Revolution when most people spent about 90 per cent of their income on food. Even the claims of Galbraith and Harrington of the deterioration of purchasing power during the 1920s are based on the false assumption that the lot of the average person worsened during that decade.

Yet, as historians admit, the lot of the common worker rose dramatically during the 1920s. When President Herbert Hoover in his innauguration speech of 1929 trumpeted to the world that the "eradication of poverty" in the United States was in sight, few persons saw fit to disagree with him. In fact, the other pre-1929 depressions in the United States usually followed periods of increases in the standard of living for most people. There is simply no historical evidence that shows that Americans have become gradually poorer since the beginning of the Industrial Revolution. The socialist claim that capitalism enriches the few at the expense of the many simply has no logical base.

There is, however, some truth to the idea of overproduction and underconsumption in times of recession. After all, many businesses in the late 1920s *did* expand greatly, only to find no markets for their goods. There *was* an abundance of farm products in the early years of the Great Depression that, for some reason, could not be sold. As one political cartoonist noted in a sketch, there was "too much oil, too much wheat and too much poverty."

It does no good, however, to only state the conditions. One must investigate the *causes* of such a calamity. There was a *reason* why wheat in America's heartland was in abundance but families went hungry. There was a *reason* that factory inventories were choked with goods that no one seemed able to buy. To simply claim that farmers grew too much wheat or factories produced too many widgets and those actions brought about the Great Depression or any other depression is to commit the fallacy of false cause. Most economic historians, however, have done just that. They have seen the results of the problem and have concluded the results were in reality the cause.

Periods of Boom and Bust Preceded by Inflation

If we are to solve the riddle of the business cycle, it is necessary to first look for common characteristics of the periods of boom and bust. And, as pointed out earlier in this paper, inflation seems to have been present in most of the boom periods. For example, in the years after Andrew Jackson killed the Bank of the United States and before he issued his famous Specie Circular in 1836, irresponsible state-chartered banks created vast amounts of paper money, much of which went to speculation on public lands, finding its way ultimately into the Federal treasury. As the supply of partially-backed money increased, Jackson became alarmed and ordered that public lands be paid for in silver and gold rather than paper. As noteholders rushed to convert their paper into specie, many banks, unable to meet any sort of reserve requirement, went under. In 1837, a panic began which brought hardships to many Americans and guaranteed President Martin Van Buren only one term of office.

In the violent but short-lived Panic of 1893, one finds the roots in the Sherman Silver Purchase Act of 1890 which required the U.S. Treasury to purchase overvalued silver with gold certificates, thus creating a run on the treasury's gold reserves. The resulting monetary crisis forced President Grover Cleveland to call a special session of Congress in 1893 to repeal the Sherman Act, thus halting the silver inflation. A deep recession began that year, an event that led to Coxey's Army (which wanted the federal government to print money to pay for public works programs, a plan Cleveland wisely refused) and the 1896 free-silver

Presidential candidate William Jennings Bryan.

During depression periods, businesses held goods they could not sell, farmers had crops, that despite low prices, no one could seem to afford. People lost their jobs; wage earners could not support their families; businesses could not expand despite the availability of cheap materials and cheap labor.

At this point one might ask: Was there any correlation between the monetary problems in the boom-bust periods and the business downturns? Were these phenomena related or was their simultaneous appearance just coincidence?

There are other questions to be answered as well. The overexpansion of one business or even a few businesses has an easy explanation: investors and entrepreneurs do misinterpret the market at times. For example, when the World's Fair recently was held in nearby Knoxville, many entrepreneurs invested in campsites, mobile homes and quickly-built motels, hoping to cash in on the expected horde of tourists. However, the flow of fair visitors, though heavy, did not fall into the preconceived patterns of some investors, which means, in the vernacular, they took a bath. There were other investors, however, who accurately read the coming markets and, indeed, did strike their fortunes.

But to take the specific, that is, the probability that some investors will misread the market, and place it in the general, or that *most* investors will misread the market at the same time—under normal business conditions—is to commit fallacies of converse accident and composition. What is true for one person may not be true for everyone; to assume otherwise is fallacious, but that is precisely what most economic historians have done.

Why the Cluster of Errors?

Yet, as one can tell by the unsold bumper crops, the glut of goods and the dashed plans of expansion that have characterized the down-side of the business cycle, those who look upon overproduction or underconsumption as the prime causes *seem* to be right. But, we must ask, why the *cluster of errors?* Why did so many investors and producers commit the same general errors at the same time, especially during the late 1920s? Few economists have sought to answer that question. Liberal historians blame the disastrous stock market speculation and subsequent crash on the Coolidge-Mellon tax cuts, which slashed the top rates from 63 per cent to 24 per cent, claiming that the rich had too much money with which to speculate (which implies, of course, that government officials spend other peoples' money more wisely than the people spend their own funds).

But tax cuts or low tax rates had never been responsible for faulty speculation or malinvestment before 1929, which makes it difficult to believe that investors, from the very wealthy to lower-class savers, had suddenly in concert thrown much of their hard-earned money into a bottomless pit. All of which leads back to the original question: Why the cluster of errors?

The answer can be given in one word: inflation. But to understand why inflation has been responsible for misleading large numbers of investors and producers at the same time, one must first comprehend the role of saving and spending in the economy.

Concerning the Role of Saving and Investment

As classical economists since Adam Smith have pointed out, the creation of wealth originates with capital, which is a product of entrepreneurial perception and action financed by savings. The basis for the productive economy—despite what politicians, journalists and liberal economists tell us—is not *spending* but rather *saving*. Consumer spending acting in concert with a free, unhampered price system serves as a guide or a rudder to the economic process. Consumers, by voting with their dollars, decide which investors are to be winners and which will lose. Spending does not create wealth; it only decides what, in the final analysis, will be considered to be wealth and what will not.

It seems logical, then, that the greater a community's or nation's pool of savings, the more opportunities to create wealth exist. But what happens when government, by injecting credit into the market via the purchase of government debt and a blip on a computer, expands the available pool of money beyond what has been saved by individuals? Free market economist Hans F. Sennholz clearly spells out the results:

> The creation of credit by monetary authorities causes interest rates in the loan market to fall below the natural rate of interest. This natural rate, or unhampered market rate, reflects the people's choices as to spending and saving, and is responsible for the relative proportions of production for the present and the future, that is, consumers' goods and producers' goods. A rising rate of saving, for instance, causes producers' goods industries to expand as more economic resources become available for expansion and modernization. If, without such new savings, monetary authorities arbitrarily expand credit, interest rates tend to fall, *which then misleads business men to invest more funds in the capital goods industries* (italics mine). Thus misled by artificially lower interest rates, they embark upon countless expansion projects that are unsupported by genuine savings. They engage in business activity that causes maladjustments and distortions.[13]

In other words, inflation misleads investors who mistake fiat rates of interest as being real or genuine rates. However, as numerous adherents to the "New Economics" have held, why can't the Federal monetary authorities continue their creation of new credit indefinitely, thus giving the economy a permanent boost?

The answer lies in the nature of inflation itself. Inflation is, as aptly said by Friedrich von Hayek, a "tiger by the tail." Continued doses of inflation to stimulate an economy soon take on a life of their own. As the amounts of fiat money are injected into the economic mainstream, prices rise—despite efforts of government officials to control them with price controls—profit margins diminish, lending authorities are forced to raise real levels of interest, thus forcing a slowdown of business activity, and the market processes continually become more and more distorted. And, as the inflation continues to drive prices beyond the reach of more and more citizens, a public outcry grows from a frightened people who demand an immediate end to the calamity.

The Rate of Saving Declines

During the inflationary period, another sinister development besides rising prices and business slowdowns occurs: the diminishing of savings rates. While inflation rages, the continuing debasing of the currency causes savings to lose their value, thus changing the engine of the economy from savings and investment to accumulation of debt. And once authorities stop the inflation, the reversal of debt-accumulation trends brings severe contractions to the economy. Without an adequate savings pool to keep interest rates at former low levels, debtors who prospered during inflation now face financial hardships.

As for the producers' goods industries that expanded during the inflation, Sennholz writes:

> The credit expansion misleads businessmen into costly errors of expansion and modernization for which there is no consumer demand. The fiscal deficits that are to stimulate economic recovery and full employment bolster some industries while depressing others.[14]

The end result, which occurs no matter if governments halt the inflation or not, is recession and unemployment. Victims of inflation may have more money in their hands, but their real purchasing power, because the troubled economy is producing less, has shrunk. That phenomenon is clearly seen at this present time with many European nations, including Ireland and England, along with our neighbor Canada, suffering from both high inflation and high unemployment. The United States, on the other hand, having brought its recent double-digit inflation rates to near five per cent, now is paying for its previous fiscal foolishness with unemployment.

A Depressed Housing Industry

A clear example of the course of inflation can be seen in our nation's housing construction industry. In the 1970s, while the federal government subsidized the industry with below-market interest rates, housing boomed, along with the related industries such as carpet-making, lumber and large home appliances. However, once inflation had finally driven the low rates far beyond the reach of the average buyer, along with pushing construction costs to record levels, the industry, along with companion producers, slipped into depression. And without a large savings pool to help finance new construction (government spending presently takes nearly 80 per cent of savings), the outlook for the housing industry, at least in the near future, is bleak.

As mentioned earlier, however, home building lobbyists have convinced the Congress to push through an ill-advised inflationary bail-out bill. But such action—which could only aggravate inflation—is to seek a cure by taking in another dose of the disease.

But, with business bankruptcies increasing and unemployment rates reaching near 10 per cent, what should government do to alleviate the problem? The answer, which may seem heartless to liberal historians, economists and intellectuals (not to mention the millions of persons out of work) is to do nothing that would add to the burden of government. As we have shown, government is the *cause* of boom and bust, the inflationary boom coming first when the original doses of credit spur ill-advised economic expansion, and the bust coming when the forces of supply and demand take their natural course. Politicians cannot repeal the law of supply and demand. Therefore, it is best for government officials to admit their inflationary mistakes and then step back as the economy goes through the painful but-usually-brief period of readjusting itself in line with market prices and wages and real consumer demand.

In fact, before the Great Depression, the policy of the federal government, once its ill-advised actions had led to boom and bust, was *laissez-faire*. The depressions, though often turbulent, were mercifully brief.

However, when the stock market crashed in the fall of 1929, following nearly a decade of an inflationary boom engineered by the Federal Reserve System, the federal government, first under the leadership of Herbert Hoover and then Franklin Delano Roosevelt, intervened at al-

> WHEN there is relative stagnation in business, and unemployment, it is usually because an unbalanced and unworkable relationship has developed between prices at which goods can be sold and their costs of production. The main difficulty, usually, is that wage-rates are too high in relation to prices. This could be cured by a readjustment of specific wage-rates, by more flexible wages and prices, by permitting competition to work. The first effect of a new injection of bank credit or paper money into the system is, indeed, an apparent increase of that "purchasing power" which is so much wanted. It enables "surplus" goods to be sold at their existing prices. It enables prices of other goods to be raised to levels at which existing wage-rates can be paid and a full complement of workers hired. So it tends to restore that "full employment" so cherished, at any cost, by the modern reformer. This goal is achieved under inflation by raising prices enough to validate the existing level of wages. But what is forgotten is that the adjustment could have been made not only just as well, but much better, by a realignment of the particular wages that had got out of line.
>
> **—from Henry Hazlitt's Introduction to Andrew D. White's *Fiat Money Inflation in France***

most every level. The Hoover administration, for example, doubled the income tax rate, pushed tariff rates to ruinous levels, attempted to cartel both industries and the agricultural sector and sought to keep both prices and wages far above market levels. Any one of those actions following the stock market crash would have seriously impaired a business recovery; together they acted in concert to bring the economy to its knees, and, in the process, throw nearly a quarter of the American work force off the job.[15]

Nor can it be said that the Roosevelt Administration acted with any more soundness. During the FDR years, the federal government assaulted property rights, inflated, stymied agricultural production, raised taxes and took ever-increasing bites from the nation's production of wealth. By acting in concert with labor union leaders in attempting to unionize much of the U.S. labor force, the government helped drive wage rates above market levels, thus touching off the ruinous depression of 1937–38. It is clear that the "humanitarian" attempts by both the Hoover and Roosevelt administrations to slow the forces of supply and demand as the nation lurched into depression in the long run only served to *increase* the human suffering so starkly depicted in the grim, austere photographs that record the anxious years of the 1930s.

The governments of the so-called capitalist West have learned little since the disasters of the 1920s, '30s and '40s. Politicians still see inflation as the best weapon to fight unemployment even while the record shows their actions to be foolish. The business cycle is still seen by many as the natural result of "unbridled" *laissez-faire*.

But there is much we can learn by examining the business cycles. By carefully studying historical economic developments, we can easily see that inflation is not the cure but rather the culprit. Inflation may, in its early days, give people an illusion of wealth; when it has run its course, however, it has borne not riches but rather poverty.

How does a nation avoid the roller-coaster of the business cycle? The words of Ludwig von Mises seem to be wise counsel:

> If the policies of nonintervention prevailed—free trade, freely fluctuating wage rates, no form of social insurance, etc.—there would be no acute unemployment. Private charity would suffice to prevent the absolute destitution of the very restricted hard core of unemployables.[16]

—FOOTNOTES—

[1]Gene Tharpe, "Fitting Economics to Economic Reality," *The Atlanta Constitution* (March 18, 1982), 5-A.

[2]Robert Lekachman, "Reverse Most of Reagan's Policies," *U.S. News & World Report* (April 5, 1982), p. 38.

[3]Marvin Miller, *The American Dream: Shadow and Substance* (Covina, California, 1976), pp. 278–279.

[4]Lawrence W. Reed, "Seven Fallacies of Economics," *Freeman* (April, 1981), p. 212.

[5]Henry Hazlitt, *The Failure of the "New Economics"* (Princeton, New Jersey, 1959), p. 33.

[6]Reed, pp. 212–213.

[7]Rodbertus accepted Ricardo's "Iron Law of Wages" that claimed that laborers would always make no more than subsistence wages because any real increase in pay would only serve to make the laborers' families larger. Ricardo's so-called "Iron Law" has historically been shown to be made of paper.

[8]John Fred Bell, *A History of Economic Thought* (New York, 1953), p. 373.

[9]Michael Harrington, "And the Poor Get Poorer," *Today's Education* (September-October, 1981), p. 31.

[10]*Time*, February 1, 1982, p. 22.

[11]For an excellent critique of long-held causes of the business cycle, read *America's Great Depression* by Murray N. Rothbard.

[12]John A. Garraty, *The American Nation* (New York, 1971), p. 608.

[13]Hans F. Sennholz, *Age of Inflation* (Belmont, Massachusetts, 1979), p. 130.

[14]*Ibid.*, p. 131.

[15]Rothbard spells out in detail the effects of Hoover's interventionism in *America's Great Depression*.

[16]Paraphrased from the William E. Rappard contribution "On Reading von Mises," in Mary Sennholz, ed., *On Freedom and Free Enterprise* (Princeton, N.J.: Van Nostrand, 1956), pp. 18–19.

Brian Summers

Economic Recovery

AMERICANS are once again hoping for an economic recovery. If recovery comes, can it be sustained? Or will it soon collapse, as have all recent upturns?

The answer depends on how the recovery is financed. If economic recovery is financed from the real savings of the American people, a sustained period of economic growth may occur. But if the recovery is induced by an artificial expansion of banking credit, any upturn will quickly abort.

To see this, we need to understand the difference between saving and credit expansion. Perhaps a simple example will make the distinction clear.

A businessman has been thinking about building a new factory. But every time he adds up the costs—construction, equipment, wages, interest on the needed loan—he decides that the factory is too expensive.

Suppose, however, more savings become available for investment. The rise in real savings may result from a tax reduction which removes some of the penalties placed on savers. Or more savings may become available due to reduced borrowing by the various levels of government. In either case, interest rates decline, not because more money is added to the economy, but because existing funds are shifted from consumption to saving.

This shift, in the long run, benefits all Americans.

The businessman benefits because lower interest rates mean he can now afford to build his factory. The construction company and suppliers benefit because they receive new or-

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ders. And workers benefit because the factory creates new jobs.

But the real beneficiary is the buying public. The businessman builds his factory because he thinks he can produce goods that consumers will prefer to those being offered on the market. He takes a financial risk because he thinks it will enable him to satisfy consumers better than his competitors. If he fails, the loss is his. If he succeeds, consumers get more of what they want and thus enjoy a higher standard of living. The consumer—each and every one of us—is the final judge and ultimate winner.

The key to real growth, therefore, is to increase the amount of savings available for productive investment. If the savings pool is allowed to grow—without being choked by tax increases, government borrowing, or other hindrances—a sustained economic recovery can get under way.

Unfortunately, in previous recessions the savings pool hasn't been permitted to grow. Taxes haven't been cut and government borrowing hasn't been reduced. Instead, the Federal Reserve System has resorted to credit expansion. It has tried to induce artificial recoveries by injecting new paper money into the banking system.

To the casual observer, these new funds seem no different from money that has been saved. Businessmen borrow these dollars, use them to expand their operations, and hire more workers. For a while, the economy appears to recover.

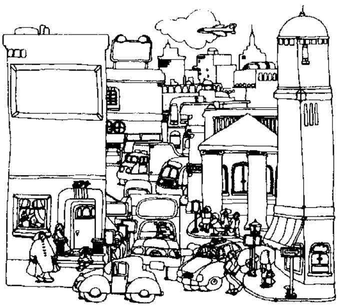
But there is a fatal difference. The Federal Reserve action does not shift funds from consumption to saving. Instead, new money has been created. As the new money works its way through the economy, prices are bid to higher levels. Rising prices cause long-term interest rates to climb, as lenders come to anticipate a depreciating dollar.

With inflation heating up and interest rates on the rise, the Federal Reserve finds itself in a vicious spiral. Credit expansion causes prices to rise, and the only way to stay ahead of rising prices is to pump more and more credit into the banking system.

Before long, prices are rising at double-digit levels, interest rates are soaring, and the banking system is overextended. The Federal Reserve has little choice now but to tighten credit, break the "inflationary psychology," and plunge the economy into another recession.

This, then, is the decision we face. Do we reduce taxes and cut government borrowing, thereby expanding the savings pool and permitting a sustained economic recovery? Or do we try to induce yet another artificial recovery through credit expansion, and reap the whirlwind when it collapses?

Russell Shannon



Constitutional Restraints, the Market Economy, and Individual Freedom

He sat at a table, and the light of his lamp fell on the copy of an ancient document. He had marked and crossed out the contradictions in its statements that had once been the cause of its destruction. He was now adding a new clause to its pages: "Congress shall make no law abridging the freedom of production and trade. . . ." —***Atlas Shrugged***[1]

IN his new book *Bound to Be Free*[2] economist Richard B. McKenzie echoes this constitutional proposal from Ayn Rand's epic novel. He urges us also to impose limitations on federal tax revenues and monetary growth. Through this approach, he believes we can restore the personal freedom which promotes both our individual growth and economic development.

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His is, of course, not a solo voice—merely one in a growing chorus which includes Nobel economists Friedrich Hayek and Milton Friedman as well as tax reformer Howard Jarvis. Together they seek to constrain not only liberal idealists with their social schemes but also conservative businessmen who seize government powers for their selfish ends.

Of course, government policies are not the only source of current discontent; disappointment with the enterprise system and distrust of business are also widespread.[3] But much of such distress flows from failure to analyze and understand market forces. A while back, for example, I overheard a lady excoriate American automobile companies for failing to produce more fuel-efficient cars. She apparently believed that General Motors and Ford, not to mention Chrysler, are managed by idiots and incompetents. Yet the "failure" she perceives is quite readily explained without resorting to such charges.

After all, the American auto companies have for over two decades been producing such small cars as the Camaro, the Falcon, and the Valiant. Even before that, American Motors devoted its main productive efforts to this end. But the American public treated these offerings with disdain. Small was not beautiful. And no wonder! Gas was so cheap that it made economizing unnecessary, even silly. And for those who worry about safety, there continues to be much evidence that bigger is better.[4]

In fact, government regulation has frequently been the factor that frustrated moves toward fuel efficiency. Mandatory guidelines for safety equipment—some of it amazingly redundant, like seat belts and padded dash boards—not to mention stringent goals for improved auto emissions, have been hopelessly contrary to efforts to improve engine economy. Now in desperation GM has announced it will import greater numbers of Japanese cars for sale here under its own name.[5]

Wasteful Use of Resources

Indeed, there is much evidence that the free market, overall, does a far better job of allocating our scarce resources to their socially optimal use than government bureaucrats can. A vivid example showing that government management is not inherently superior is the approach taken by the Forest Service in managing our timber resources. As explained recently by Thomas M. Lenard of the Office of Management and Budget, the Forest Service imposes a "nondeclining even flow" scheme for cutting trees which, Lenard says, "arbitrarily limits the timber harvest in any one period and stretches it out for decades beyond the point of economic efficiency." In another policy the Service prevents trees from being cut "until they reach the age that maximizes average annual growth. It is based on biological criteria and has no economic rationale," Lenard notes.[6]

According to one estimate Lenard quotes, if these policies were eliminated and timber production were concentrated in the most productive areas of our national forests, wood production might increase by as much as 74 percent—requiring 27 percent fewer acres! And the marvelous fact is that this process would not only allow more timber production (with the associated benefits of reducing construction costs, which would give the housing industry a needed boost); it would also "*triple* the amount of forest land in the area on which timber harvesting is not permitted," thereby greatly increasing the area available for recreational purposes. Under such an improved management system, both private and public uses of our valuable timber resources would flourish.

Of course, a privately managed firm may similarly excel at inefficiency. In fact, it would be easy to offer a long list of examples. But if a business is poorly run, its profits will drop, its shareholders will dispose of their stock, and the company will quietly disappear. Like W. T. Grant, it may not even be remembered by a tomb. Or, as in the case of General Motors with its Frigidaire appliances, if the parent company can no longer manage a subsidiary effectively, it will sell it off.

Free of Competition

But how often can we anticipate that process with government? We are usually far less certain that pressure will come to bear to assure that, if a government agency is not using resources efficiently, it will be replaced by someone who can.

In fact, private producers so envy the security which government management provides that they frequently seek to take advantage of it. Chrysler and Lockheed are but two of the companies which in recent years have benefited from government bailouts. A multitude of other producers have received assistance in substantial but far less obtrusive ways.

A striking case in point is the "filbert fracas" in Oregon. A couple of years ago that state tightened up quality standards for filberts to prevent "decayed" nuts from appearing on the market. Consumers had not complained; it was producers who sought the rule. As reported in *Regulation,* this new rule automatically became part of the federal marketing standards and thereby was imposed on the entire nation.[7] Here is what followed: "imported filberts, most of which come from the Black Sea regions of Turkey, are air-dried in the traditional way and shipped at ambient temperatures, whereas the American nuts are uniformly machine dried, inspected as soon as they are shelled, and then shipped under refrigeration. According to Agriculture Department estimates, 46 percent of shelled filbert imports surveyed recently would fail the new and stricter test. Importers often would not know in advance whether a particular shipment would pass the test, however, and a nutty cargo turned back at an American port would have to spend another eight weeks at sea for the return trip. The combination of uncertainty and expense would be enough, importers say, to keep out 80 percent of the foreign nuts." In effect, the ruling neatly disposed of much, if not all, foreign filbert competition, to the benefit of Oregon filbert farmers but to the detriment of consumers. In fact, some activist consumer groups have condemned the filbert ruling and urged its repeal.

Of course, this is but one example from a large array of cases where American producers have sought protection from foreign imports. Some attempts at stifling free markets, such as those by producers of cars and textiles, have received widespread publicity. Most, however, like the case of filberts, are unknown and go unnoticed. A while back, the *Washington Post* noted that import restrictions have been sought on such diverse items as canned Bartlett pears, ice cream sandwich wafers, bicycle speedometers, plastic mattress handles, water circulating pumps, and dried eggs.[8]

Why do economists object to such trade restrictions? Primarily because they raise costs and reduce choices for consumers. While producers find their profits enhanced, consumers are impoverished. But as McKenzie stresses in his book, such policies designed to help producers and maintain employment in one industry also have the secondary impact of hurting producers and reducing employment in other industries.[9] In effect, businessmen are using government to wage a wasteful war among themselves.

A notable example involves policies designed to inhibit "dumping" of foreign steel in our markets. Whatever the justice of helping our steel industry may be, one baleful effect is to raise the cost of steel for American automobile producers. They are now forced to pay more for steel, even if they don't actually buy from foreign sources. As a result, GM, Ford, and Chrysler find it more difficult to compete with their German and Japanese rivals, who can produce cars using less expensive foreign material.

But that too is just one example among a vast multitude of others. Peter Paul Cadbury and Entenmann's have opposed the filbert ruling because it would raise the prices of their candies and pastries, thereby discouraging sales and dampening profits. A more notable current case involves the quotas on sugar imports imposed by the Reagan administration. Although designed to relieve distressed domestic sugar growers, the quotas came as a cruel blow to some independent U.S. refiners of sugar imports. A few even foresaw the possibility of having to close down.[10]

Minorities vs. Majorities

Too often, these secondary effects of selfish policies sought by producers are not foreseen. Moreover, those who benefit are commonly concentrated; those who are harmed are usually dispersed. Thus a minority may readily achieve its goal at the expense of the majority. In the end, the social costs outweigh the social benefits.

But along with selfishness is another fault—simplicity. A crucial underlying failure of advocates of government regulation and control is that they almost always ignore the variety of individual talents and tastes. This profound fact provides a vital, underlying thrust in McKenzie's work.[11]

For emphasis and illustration, McKenzie refers to economist Frank Knight, who "used to puzzle his students at the University of Chicago with the elementary question, 'What is an apple?' If called on, we can all identify an apple, but once we reflect seriously on the puzzle, we begin to understand that apples are different things to different people."[12] For growers, they are a source of profits; for cooks, the basis of pies; for students, a gift to teachers. Spelled with a capital A, they are now a vibrant force in the burgeoning computer industry!

The critical point which Knight and McKenzie stress is that all of us are essentially different. In fact, human beings are as unlike as snowflakes—or our fingerprints. One man who has dwelt at length on individual variety, Roger J. Williams, past president of the American Chemical Society, points out in a book called *Free and Unequal: The Biological Basis of Individual Liberty* that even our handwriting and breathing patterns are distinctive.[13]

What is particularly crucial here, however, is the variety in people's tastes. It has been revealed through tests with a substance called phenylthiocarbamide. According to Williams, in one study involving over six thousand people, "65.4 percent said it was *bitter,* 21.3 percent pronounced it *tasteless,* 5.4 percent said it was *sour,* 4.8 percent said *salty,* 2.1 percent said *sweet,* and the remaining 1.9 percent thought it tasted like miscellaneous fruits and vegetables—rhubarb, lemons, cranberries, etc."[14] Williams even notes a dramatic difference in our ability to smell. "I know of three individuals," he says, "who have ordinary sense of smell in most respects, but are unable to smell the odor of skunk, even when it is very strong. To most people the skunk odor is most unpleasant. I know of two individuals whose reaction is different. One likes the odor. The other likes it if it is not too strong."[15] With such disparity of tastes, no wonder there are now so many kinds of cars, clothes, and even breakfast cereals!

The Wondrous Brain

Carl Sagan gives further evidence of individual variety in his discussion of the human brain, which, Sagan says, functions through the use of connecting links called "synapses." According to Sagan, "the human brain is characterized by some 10^{13} synapses. Thus the number of different states of a human brain is

2 raised to this power—i.e., multiplied by itself ten trillion times. This is an unimaginably large number, far greater, for example, than the total number of elementary particles (electrons and protons) in the entire universe."[16]

These amazing numbers boggle the mind. It cannot comprehend itself! What are the implications? Sagan continues: "It is because of this immense number of functionally different configurations of the human brain that no two humans, even identical twins raised together, can ever be really very much alike. These enormous numbers may also explain something of the unpredictability of human behavior and those moments when we surprise even ourselves by what we do. Indeed, in the face of these numbers, the wonder is that there are any regularities at all in human behavior."

Confronted by this astonishing variety, Sagan reaches a dramatic conclusion. "The answer must be that all possible brain states are by no means occupied; there must be an enormous number of mental configurations that have never been entered or even glimpsed by any human being in the history of mankind. From this perspective, each human being is truly rare and different and the sanctity of individual human lives is a plausible ethical consequence."

How does an economist view this variety? At least one has spoken directly to the point. Friedrich Hayek notes that "the knowledge which any individual mind consciously manipulates is only a small part of the knowledge which at any one time contributes to the success of his action."[17] No one knows fully the factors which enter into his motivation and his behavior. But, more importantly, no outsider can possibly discern all that dwells within another's brain. Furthermore, Hayek says, "the sum of the knowledge of all the individuals exists nowhere as an integrated whole. The great problem is how we can all profit from this knowledge, which exists only dispersed as the separate, partial, and sometimes conflicting beliefs of all men."[18]

No One Knows

The futility of trying to plan and organize human activity centrally is admirably evoked in a recent statement by Dennis O'Brien, a deputy assistant secretary of our Department of Energy. "All forecasters, both in the government and in the private sector," O'Brien states, "have been awful at figuring out where the energy markets were headed the past few years."[19] No one possesses sufficient information and insight to predict even the energy future accurately.

Given the variety and essential mystery of human tastes and drives, what are the implications for social organizations? How can we best tap these various skills and tastes? For Hayek as well as for McKenzie, Friedman, and others, the answer is simple and straight-forward: free markets.

This suggestion is, of course, not new. Two hundred years ago Adam Smith wrote in a famous passage which McKenzie quotes: "by directing that industry in such a manner as its produce may be of the greatest value, [an individual] intends only his own gain, and he is in this . . . led by an invisible hand to promote an end which was no part of his intentions. Nor is it always worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of society more effectually than when he really intends to promote it."[20]

Almost a century later in his famous essay *On Liberty* John Stuart Mill echoed Smith: "it was once held to be the duty of governments, in all cases which were considered of importance, to fix prices, and regulate the processes of manufacture. But," Mill continued, "it is now recognized, though not till after a long struggle, that both the cheapness and the good quality of commodities are most effectively provided for by leaving the producers and sellers perfectly free, under the sole check of equal freedom to the buyers for supplying themselves elsewhere."[21] He further noted, in complete accordance with the illustrations previously presented, that "restrictions on trade . . . do not really produce the results which it is desired to produce by them."

Mill was so outspoken an advocate of individual liberty that a few years ago the American economist Paul Samuelson commented in his presidential address to the American Economic Association: Mill's "views on liberty will, even in the post-Freud world, never go out of date and can perhaps best be summarized in the words of Mrs. Patrick Campbell, Bernard Shaw's pen-mistress: People should be allowed to do anything they like—provided only they don't scare the horses in the street."[22]

Can Consumers Be Trusted to Guide Economic Action?

But do the ideals of Smith and Mill still hold? After all, the scale of industry has vastly changed. Can we depend, in this complex and cosmopolitan age, on the luxury of allowing self-centered individuals to be the fundamental guiding mechanism for production?

In fact, there is evidence that we not only can but must. After all, even now, in order to make a profit, particularly over the long haul, producers must provide a good or service which consumers want. Somehow, if they are to survive, they must determine what it is that millions of Americans truly desire.

Indeed, as McKenzie points out, the invisible hand and free markets evoke the very essence of individualism. "If we were all alike in preferences and abilities—identical—there would be no basis for so many of the markets we observe in the real world."[23] It is because, while some of us are gardeners or golfers, others are numismatists, philatelists, spelunkers, and scuba divers that the multitude of markets exists.

There is another element besides individual *tastes* to consider and that is individual *talents*. Since they also differ, we need a system of social organization which encourages all people to develop their own individual skills. This certainly entails selfishness of sorts, but it has some admirable social advantages. Two modern writers have expressed the matter as follows: "Concern for others implies concern for oneself in the following way: to be concerned for the well-being of another is to want to contribute to that well-being; but we can contribute nothing of worth to others unless we have taken the trouble to cultivate resources in ourselves, and this implies self-concern."[24] As John Stuart Mill put it: "In proportion to the development of his individuality, each person becomes more valuable to himself, and is therefore capable of being more valuable to others."[25] We cannot, in short, give to others unless we have something of our own to give.

The Virtue of Individualism

Individualism thus construed is not the epitome of selfishness or self-centeredness. It is not a social vice but rather a social virtue. It is in finding ourselves that we can best use our talents for the social good. In his work *The Constitution of Liberty,* Friedrich A. Hayek quotes a passage from H. B. Phillips which underlines this point: "In an advancing society, any restriction on liberty reduces the number of things tried and so reduces the rate of progress. In such a society freedom of action is granted to the individual, not because it gives him greater satisfaction but because if allowed to go his own way he will serve the rest of us better than under any orders we know how to give."[26]

In studies of American and British industrial development over the last two centuries, much is often made not only of the sordid state of working conditions but also of the "Robber Barons" whose greed seemed bound to destroy both our natural and our human resources. Too little has been said of inventors and entrepreneurs whose new ideas and initiative unleashed a plethora of revolutionary innovations.

In Britain two centuries ago there was, for example, the remarkable coterie including James Watt, Matthew Boulton, Josiah Wedgwood, and others who comprised the Lunar Society of Birmingham.[27] In the U.S. during the late 1800s there was an even greater host of innovative individuals, most conspicuously Thomas Edison but including also many others such as Borden, Swift, Armour, Walgreen, Eastman, and Birdseye. Their stories have been marvelously retold by Daniel Boorstin in his book *The Americans: The Democratic Experience.*[28]

Nor have we any reason to believe that individual variety and initiative are any less lacking today than in the past. Examples run the gamut from such medical advances as CAT scanners and interferon, to cable TV and video games, even to a report in the *Wall Street Journal* that, despite all the furor over nuclear weapons and waste, residents of one town in Colorado are actively seeking establishment of a low-level nuclear-waste dump in their area for the jobs it would provide. (Their promotion of the project includes bumper stickers which read "Nuclear Power Plants are Built Better Than Jane Fonda!")[29]

To solve all our energy, environmental, and economic problems, is it not essential that we allow all possible opportunities for the full development of individual talents and diversity? In his book, McKenzie rightly deprecates many Keynesian economists for prescribing government deficits which have unleashed an unwarranted (and often unwanted) expansion of government's role. However, it should be noted that the famous British economist is not always well read by his own disciples. If they paid close attention to his famous work, *The General Theory of Employment, Interest and Money,* they would discover toward its end what may well be one of the most eloquent passages ever written about the advantages of individualism.

"Let us stop for a moment to remind ourselves what these advantages are," Keynes wrote. "They are partly advantages of efficiency—the advantages of decentralization and of the play of self-interest. The advantage to efficiency of the decentralization of decisions and of individual responsibility is even greater, perhaps, than the nineteenth century supposed; and the reaction against the appeal to self-interest may have gone too far. But, above all, individualism, if it can be purged of its defects and its abuses, is the best safeguard of personal liberty in the sense that, compared with any other system, it greatly widens the field for the exercise of personal choice. It is also the best safeguard of the variety of life, which emerges precisely from this extended field of personal choice, and the loss of which is the greatest of all the losses of the homogenous or totalitarian state. For this variety preserves the traditions

The Authoritarian Society

THE authoritarian society is the natural and stable form of society because it is in solid conformity with the survival characteristics of the human being. It is dominant in history. Once established it tends to perpetuate itself because those wielding power seldom give it up short of bloodshed. If an authoritative state is overthrown through organization and exercise of still greater physical power, then the wielders thereof won't let their power go after they have won. They just become the new set of rulers. Hence, much of human history is the story of a squirrel-cage succession of one authoritative regime after another from which the people almost never break out, as you may see in many countries of the world. George Washington was the exception. He refused to become our king; he gave up his wartime powers and insisted upon establishment of a representative republic of limited power. He uniquely opened the door to the squirrel cage. We can, of course, crawl back into the cage, well-baited with promised security; and the door will then snap shut.

—BRADFORD B. SMITH, "Our Unique Economic System"

which embody the most secure and successful choices of former generations; it colours the present with the diversification of its fancy; and, being the handmaid of experiment as well as of tradition and of fancy, it is the most powerful instrument to better the future."[30] In Keynes' view, both the individual and society reap a great harvest from planting the seeds of free choice and initiative.

Thus it is that McKenzie and others advocate adoption of Constitutional constraints on government. Surely, some flexibility will be sacrificed. Moreover, it remains true that government has important roles to play, providing for "public" goods such as defense and dealing with "externalities" such as pollution. Some people would also reasonably require efforts to protect consumers from fraud.

A Dangerous Course

While it can be admitted that the distribution of income provided by a free market economy may not be ideal, it is still not clear that government intervention will improve on matters. In fact, the danger in our present course is that, without some effective constraints on both liberals' and conservative businessmen's redistributive schemes, both economic growth and the individual freedom that enable incomes to rise will be eroded to the point of extinction. That is a possibility no less awesome than a nuclear holocaust.

Right now, many people, out of deep concern for both ourselves and our posterity, seek to avoid that awful destiny by advocating a nuclear weapons freeze. Isn't it equally essential to lend our efforts to developing policies to assure that markets and individuals are free?

—FOOTNOTES—

[1]Ayn Rand, *Atlas Shrugged* (New York: Signet, New American Library, 1957), p. 1083.

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[5]John B. Schnapp, "GM Shakes Up the Auto Industry," *Wall Street Journal*, May 26, 1982, p. 30.

[6]Thomas M. Lenard, "Wasting Our National Forests," *Regulation*, July/August 1981, pp. 29–36.

[7]"Dispatch from the Nut Wars," *Regulation*, January/February 1982, pp. 8–10.

[8]Jane Seaberry, "Dumping Cases: Ice Cream, Steel, Carts and Pears," *Washington Post*, May 4, 1980, p. G1.

[9]McKenzie, pp. 120–22.

[10]"Sugar Imports to Be Limited, Reagan Decides," *Wall Street Journal*, May 5, 1982, p. 4; "Sugar Refiners' Group Files Lawsuit to Halt Quotas on Imports," *Wall Street Journal*, May 12, 1982, p. 47. Indeed, the Reagan Administration's stance on "free trade" has been the subject of some sharp attacks; see Sheldon L. Richman, "Examining Reagan's Record on Free Trade," *Wall Street Journal*, May 10, 1982, p. 30, and Clifton B. Luttrell, "Reagan's Farm Economics," *Competition*, III (May 1982), pp. 8–9.

[11]See especially Chapter 3.

[12]McKenzie, p. 55.

[13]Roger J. Williams, *Free and Unequal: The Biological Basis of Individual Liberty* (Indianapolis: Liberty Press, 1979), Chapter 4.

[14]*Ibid*, p. 63.

[15]*Ibid.*, p. 70.

[16]Carl Sagan, *The Dragons of Eden: Speculations on the Evolution of Human Intelligence* (New York: Random House, 1977), p. 42.

[17]Friedrich A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), p. 24.

[18]*Ibid*, p. 25.

[19]George Getschow, "More or Less Oil Will Go Up or Down or Maybe It Won't," *Wall Street Journal*, May 5, 1982, p. 1.

[20]Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Modern Library, 1937), p. 423.

[21]John Stuart Mill, *On Liberty*, in Edwin A. Burtt (ed.), *The English Philosophers from Bacon to Mill* (New York: Modern Library, 1939), p. 1024.

[22]Paul A. Samuelson, "Economists and the History of Ideas," *American Economic Review*, LII (March 1962), p. 11.

[23]McKenzie, p. 63.

[24]David L. Norton and Mary Kille Norton, review of *Sex Without Love* by Russell Vannoy, in *Reason*, May 1982, p. 57.

[25]Mill, p. 998.

[26]Hayek, p. 9; quotation is from H. B. Phillips, "On the Nature of Progress," *American Scientist*, XXXIII (1945), p. 255.

[27]Lord Ritchie-Calder, "The Lunar Society of Birmingham," *Scientific American*, June 1982, pp. 136–45.

[28]Daniel J. Boorstin, *The Americans: The Democratic Experience* (New York: Vintage Books, Random House, 1974).

[29]Eric Morganthaler, "To Keep Their Town Alive the Residents of Naturita, Colo., Want a Nuclear Dump," *Wall Street Journal*, July 1, 1982, p. 21.

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Roger M. Clites

Through Others' Eyes

WE are often reminded by the news media of the value placed on political freedom by those who challenge overwhelming odds to escape from iron curtain nations, be they in eastern Europe, Asia, the Caribbean, Central America or elsewhere. Occasionally slight mention is also made of a desire for economic freedom. However, the emphasis nearly always is on escape from political repression. (In fact, our federal government policies concerning refugees allow that status only on the basis of political repression, not on the basis of economic repression.) My purpose here is to recount the importance of the relative economic freedom of the United States to two citizens who spent their early years in other economies.

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Herman was a university student I had in several classes between 1956 and 1959. A few years earlier he had won a competition among 1300 students about to graduate from the gymnasium level of German education. The prize was a year of college study in the United States. Based on his observations of the relatively greater amount of economic freedom in the United States, Herman resolved to return to America and to become a citizen. At that time the quickest way for Herman to secure United States citizenship was to enlist for a period of servitude in the U.S. military; so he joined the navy.

I first met Herman when he was working in a camera store and attending my night class in "Principles of Economics." Early in that course he taught all of us something I've cherished ever since. I had been listing and discussing with the class various reasons why the U.S. economy out-performed that of other nations. We discussed such matters as abundant natural resources, geographic removal from the destruction of most major wars, settlement of the country by ambitious and able immigrants and other factors. Herman then pointed out that we were overlooking the most important of all considerations. He called that matter, "non-policies of government." He went on to explain what he meant by giving several examples, both of government policies and of traditions and attitudes that complemented those policies, which fostered and perpetuated economic waste in his homeland.

The Academic Route

Herman rapidly took advantage of the relative economic freedom he found in the United States. A year following our first meeting he was still working to support himself but was now attending the university full-time so as to ready himself to enter a higher level of the work force as soon as possible. When Herman graduated the next year, he had been voted two honors. The faculty selected him as the student who had contributed the most to the school of business during his student years. Remember, he did this while working his way through the university. Meanwhile, his fellow students selected him as "most likely to succeed." Herman was a talented person, pursuing an "intellectual" path to economic improvement.

The other person I have in mind was more a "common man," though uncommon in many ways. He called himself "Pete," since most people in this country could not or would not learn his real name. He migrated to the United States from Greece in 1957 at age 18 with no knowledge of English and little more than a dream. Pete started working at the commonest of common labor while learning the language. After a time he became manager of a soft ice cream store.

When Pete was 23 years old he decided he wanted to marry Anne, one of his customers, who was about to graduate from college. Anne's father might well have objected to the marriage on religious grounds. She was Southern Baptist and Pete was of nominal Orthodox persuasion. However, her father took an economic approach. He pointed out to Pete that his thriving automobile dealership had made it possible for him to provide well materially for Anne and questioned whether she would long be happy with Pete's earnings.

As usual, Pete saw this as one more temporary obstacle to be overcome. He consulted with some of his friends in the local Greek community who happened to be in the restaurant business. They told him they had learned that they could cut their costs of produce more than half by buying directly from nearby farmers. So, Pete decided that he could buy directly from the farmers, who were in the Carolina Piedmont region, and successfully compete with the large wholesalers who sold to stores and restaurants in the mountain area 100 to 150 miles to the northwest. He challenged Anne's father to help him finance a used pickup truck with the claim that within six months he could be earning more than the father earned from his auto dealership. The truck purchase was arranged.

Entrepreneurial Achievement

Pete made good his prophecy. The large wholesalers had the expense of storage warehouses, sales commissions, management salaries, truck drivers' wages and, most of all, spoilage costs of up to one-third of their produce. Pete, however, was management, salesman and truck driver combined. His glove compartment was his office. Every day he worked until the large "dog house" he had built to protect and contain goods on the rear of his truck was sold out, so he had virtually no loss due to spoilage. He charged at least 20 per cent lower prices than the big wholesalers, so he had no trouble selling his merchandise.

I met Pete in 1965 when he was 25 years old. He and Anne lived in an apartment house I managed and Anne was in two of my classes studying toward her MA degree. Pete normally worked three days a week for about 14 to 16 hours, each. He would make $200 to $300 per day. (Remember, this was 1965 when prices were roughly one-third what they are today.) Pete once worked six consecutive days to see how much he could earn in a week. It came out about $2000, he claimed. Even if he exaggerated, he must have done quite well. I used to tell him he would either be a millionaire or dead by his 40th birthday. He claimed his primary goal was to make it possible for Anne to earn her PhD from Harvard.

I was next in touch with Pete in 1969. He was in Boston collecting substantial royalties from a route of coffee vending machines he had established. Anne was home with their little girl, but was planning to begin work on her doctorate before long.

When our paths next crossed in 1980, Pete was almost 40 years old. Anne had her doctorate, not from Harvard, but from another university in the Boston area. She was head of her department at a community college in Boston. Pete still collected royalties on his ever-expanding coffee machine routes and owned upwards of a dozen store buildings plus other real estate. He, Anne and their two children spend each Christmas vacation in either Florida or the Caribbean. Every other summer they visit his family in Greece for an extended period.

These two entirely different men came to the United States from greatly divergent backgrounds, saw the opportunities available in this land of relative economic freedom and put into action their appreciation of the opportunities available to them. Herman took the approach of education and, eventually, the corporate world. Pete, who arrived without either skill or knowledge of the language, decided to learn the language and put to work whatever talents and abilities he could find within himself. He was able to see what was needed or wanted, wherever he located, and set out to provide it at a price that would be competitive and yield him a good income.

Why is it that these men who were not accustomed to our relative economic freedom could profit so much more from it than can most who have grown up surrounded by it? Perhaps it is because they appreciated it, whereas we take it for granted.

Freedom, Productivity, and Progress

IDEAS ON LIBERTY

EMERSON once remarked that if a man made a better mousetrap the world would beat a path to his door, but he neglected to mention what some of the folks would do when they got there. It is to be expected that the Amalgamated Mice of America would mouse-cott the new arrangement, nor can one help sympathizing with those who may be hurt in the short run by the march of progress. But more than likely, the Emerson Better Mousetrap Company would come in for a lot of opposition from others with less obvious reasons for objecting to the innovation. Unfortunately, it seems that ever since our stone age grandparents thought of moving out of the cave, anyone who upset the status quo by trying to do things a bit more efficiently has been suspect. Doubtless that is why human history is largely the story of poverty and stagnation.

We often fail to realize how hard it was to get the machine age in motion and how hostile forces threatened to swallow the fresh new ideas which sparked this revolution before it got started. . . .

The sudden burst of productivity, coming nearly two centuries ago to a world with a chronic and psychopathic fear of abundance, generated a bitterness against the machine which persists even today.

EDWARD P. COLESON

THE COMING BOOM

David Raboy, a Washington-based economist, has come up with an unconventional view of the inflation and subsequent depression of Andrew Jackson's day. Jackson's war on the Second Bank of the United States had nothing to do with the case. It was the British substitution of opium for silver in making payments to the Chinese for tea and silks that caused Jackson's troubles. The opium released silver to flow into the United States. When Britain later encountered difficulties at home, the withdrawal of silver caused the panic of 1837.

Thus events that are not comprehended by politicos control the course of history in ways that mock fiscal and monetary policies. Herman Kahn, in his *The Coming Boom* (New York: Simon and Schuster, 237 pp., $14.95), though he approves of much that the Reagan Administration has been doing, thinks that America is about to experience a revitalization no matter who occupies the political seats of so-called power. Things are happening for cyclical reasons that control individual and group psychologies, and the spill-over into economics will be of happy consequence no matter what transpires on the Potomac.

Kahn admits that the federal spending of the past thirty-five years has been unfortunate, but he doubts that it will prove fatal. For, while the spending has doubled in constant dollars, the Gross National Product has tripled. Expenses at the local level may be a far more troublesome problem. Kahn counts on a sobering period in which people will rediscover the ideas of caution and discipline. Holding a job is now something to be prized. The work ethic is no longer despised. The feeling that there are no overwhelming material limits of growth (as contrasted with socially imposed limits) has induced a new optimism. Books such as the Club of Rome's *Limits to Growth* and the *Global 2,000* report that was instigated by Jimmy Carter have been discounted.

Energy costs have figured in many a recent price increase, but the OPEC energy cartel has lost much of its menace. Kahn thinks its ability to set prices has peaked, and we can count on two decades during which a $40 top for a barrel of oil will be unobtainable. Meanwhile the abolition of price controls will insure significant discoveries of new sources of oil and gas in non-OPEC countries.

The "New Class"

Kahn worries a bit about the so-called New Class of "liberal" intellectuals who encourage an unwise distortion of market forces for non-market purposes. As children of their own parents' affluence, the members of the New Class command incomes ranging from $25,000 to $100,000 a year. Satisfied with their own status, they work to impose laws and regulations that keep others from achieving the golden circle. In the name of ecology they fight the uncovering of new sources of minerals, forest products and energy. But they have been losing ground lately. Blue collar workers who are interested in holding old jobs or getting new ones no longer follow the dictates of the "liberal" elite in matters pertaining to environmental purity. Trade-offs have become respectable, and cost-benefit analyses are the new order of the day.

Kahn puts a lot of trust in the fact that the young grow older. The children of the "baby boom" period are now reaching the "nesting age," which has conservative implications. Faced with the need to spend on durable goods, they have a sudden interest in fighting inflation.

"High Tech"

Kahn is quite aware that our old basic industries—steel, automobiles—are in trouble. But we are in the early stages of a change to "high tech," which will surely expand the economy in thousands of still unplumbed ways. Using the new shorthand of the silicon chip age, Kahn speaks of C4I2 technologies. The "C4" stands for "command, control, communications, computing"; the I2 for "information and intelligence." The new systems make remote library access available to everybody. The advent of C4I2 systems add new dimensions to the procurement, processing and use of intelligence.

Companies such as General Electric use computers and existing telephone networks to achieve instantaneous and inexpensive communications with major cities around the world, drawing at the same time upon files stored in a single location.

The new dynamics of high tech are destined to pound some new common sense into union leaders who have spent the past thirty years in devising new ways of milking the industrial cow without feeding it. Roger Smith, the chairman of General Motors, has said that "every time the cost of labor goes up $1 an hour, 1,000 more robots become economical." The use of robots will probably increase by 35 per cent a year through the 1980s. Thus high tech will come to the rescue of traditional industries that are fighting hard to live in the same world with the Japanese, the West Germans and such newly emergent industrial nations as Taiwan, Singapore and South Korea.

In matters of military defense Kahn derives solace from situations that other people have deprecated. When four or five powers besides Soviet Russia and the United States have nuclear missile capacity, the need to keep a wary eye on "swing" military establishments may help mitigate the confrontational zeal of the biggest powers. Russia and the United States might even have an interest in promoting a general "freeze" that would not only extend the peace but save everyone a lot of money.

Commodity Bonds and Unconventional Finance

Kahn doubts that a return to the gold standard is in the immediate offing, but he thinks the United States might experiment with bonds payable in gold. He also champions what he refers to as commodity bonds. An oil bond, payable in a certain amount of oil, might be issued to facilitate the build-up of an oil reserve, with the stored oil providing a guarantee that the bonds would be cashable on maturity. Since payment would be in a stipulated quantity of oil, inflationary worries would disappear. Bonds could be issued with mineral backing other than gold. Kahn hasn't gotten anywhere yet with his commodity bond idea, but he has his hopes. He thinks we are just beginning to explore the wide possibilities of what he calls "unconventional finance." Contracts don't necessarily have to be written in terms of money—or "I owe you nothings," as John Exter would have it, referring to the world's fiat currencies.

By the year 2,000 A.D., says Kahn, we will be able to do things that would have seemed miracles or magic 200 years ago. It is an exciting world that waits for us if the presuppositions of *The Coming Boom* stand up.

THE SPIRIT OF DEMOCRATIC CAPITALISM

by Michael Novak
(An American Enterprise Institute/Simon & Schuster Publication, 1230 Ave. of the Americas, New York, New York 10020, 1982)
434 pages ■ $17.50 cloth

Reviewed by Tommy W. Rogers

IF this book does not become a classic catalytic agent on behalf of the natural system of liberty—as opposed to the command society of socialism—as the desirable political economy on the basis of theological reason, it will not be due to any fault of Mr. Novak. The author must be credited with a major achievement. He set for himself the task of articulating a moral theory and a theological base for the implicit ideals of democratic capitalism. His success is to have made a credible, compelling, intellectually solid and theoretically sound presentation of the political economy of the free society. He shows it to be the spiritually and morally commendable alternative to the collective and compulsive ethic of socialism.

If, as Novak asserts, social forms are constructs of the human spirit, the first of all moral obligations is to think clearly. This is an objective wherein the theological proponents of socialism, whether in the form of Catholic "liberation theology" or the collectivism of Protestant theologians, are neither totally honest nor innocent. Novak feels it a sad commentary that

> . . . few theologians or religious leaders understand economics, industry, manufacturing, trade and finance. Many seem trapped in pre-capitalist modes of thought . . . Many swiftly reduce all morality to the morality of distribution. They demand jobs without comprehending how jobs are created. They demand the distribution of the world's goods without insight into how the store of the world's goods may be expanded . . . They claim to be leaders without having mastered the techniques of human progress.

Novak first inquires into the structural dynamics which are requisite for and, in turn, give nurture to the economic order which expresses itself in a noncoercive society, a social order within which individuals and peoples may realize, through the vocations to which they believe they have been called, the greatest degree of personal dignity, human freedom and personhood. The free economy requires in practice a moral-cultural ethos, and it is a failure of democratic capitalism not to have made a moral presentation of itself to the world. The result, as Novak sets it forth, is that capitalism

> . . . discusses itself and allows itself to be discussed, in sheerly material and procedural terms. The intellectuals of those incredibly varied nations ideologically

tied together as the "Third World" heap upon it a burden of guilt they do not consider attributing to themselves. There has grown up, as P. T. Bauer observes, a dishonorable international politics. It is morally wrong, not only intellectually dishonest, to cooperate with such ideas and values, and to deny before the world those moral-cultural qualities without which neither economic development nor democratic governance can be achieved.

Novak next examines the socialist idea and displays its hollowness against the backdrop of the realities and the promise of democratic capitalism. The genius of the free society is its recognition that the most precious of all common goods is the individuality of each person, and that the best way to increase the common good is to empower people through differentiated systems.

Collectivism, by contrast, pits man against man. It narrows the circles of trust and goodwill as groups competing for the same allocations run afoul of each other's interests. The end result is a zero-sum society which promotes the Hobbesian "war of all against all." Economic growth, liberty, and opportunity for social mobility on the other hand promotes charity, trust, and cooperation.

The third section of Novak's inquiry into the spiritual wealth of nations, and the practical import and manifestations of this wealth in quality-of-life, is devoted to an attempt to set forth a religious perspective on democratic capitalism. Not even a society free politically, economically and culturally holds out the promise of perfectionism or utopia; it does not claim to represent the Kingdom realized. The finest social order conceivable has to be practiced by men as they are, with all the foibles and propensities for evil by which men, in reality, are characterized. Thus, constant assessment, evaluation, modification, in the light of democratic capitalism's own ideals is desirable, possible, and necessary.

There has been, as Novak recognizes, a failure of the moral-cultural leaders of democratic capitalism to sow widely a moral vision promotive of the system of natural liberty. While, under the capitalistic political economy bread is more abundant, more equitably distributed, and less scarce and dear, even here human beings do not live by bread alone. In no major sphere of life have the traditions of theology fallen further behind. Many contemporary theologians and other intellectuals seek a return to the unitary society from which democratic capitalism provided liberation. Novak has addressed attention to the life of the spirit of democratic capitalism with a solidity and insight which deserves to have a crucial and long-lasting impact.